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Supreme Court, U.S.
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In The

Supreme Court of the United States

WESTERN WIRELESS CORPORATION,
Petitioner,

v.

DEPARTMENT OF REVENUE,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of South Dakota

PETITION FOR WRIT OF CERTIORARI

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79 pp

QUESTION PRESENTED

May a state constitutionally impose a use tax on services purchased and performed entirely outside the taxing state, solely on the ground that the services are an input to the purchaser's business (for which it has some in-state customers), as to which business the state imposes a separate sales tax.

PARTIES

Pursuant to Rule 14.1(b), the following list identifies all the parties to the proceeding in the Supreme Court of South Dakota, whose judgment is sought to be reviewed.

Appellant below: Western Wireless Corporation ("Western").[1] Pursuant to Rule 29.6, Western states that it has no parent corporation and no publicly held company owns 10% or more of Western's stock.

Respondent below: South Dakota Department of Revenue ("Department").

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[1] Sioux Falls Cellular Communications Corp. was merged into Western Wireless Corporation in 1995.

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PETITION FOR WRIT OF CERTIORARI

Petitioner Western respectfully requests the Court to issue a Writ of Certiorari to review the opinion of the Supreme Court of South Dakota in this case. While the Court has addressed the application of Commerce Clause principles to a variety of taxes,[2] it has not yet considered their application to a newer and increasingly important form of tax –use tax imposed on services– and the state court's erroneous application of those principles warrants the Court's review at this time.

OPINIONS BELOW

The opinion of the Supreme Court of South Dakota, reported at 665 N.W.2d 73, is set forth in Appendix A at 1a to 18a. The Memorandum Decision and Judgment of the South Dakota Circuit Court are set forth in Appendices B and C, respectively, at 19a to 36a. The Amended Proposed Decision of the Hearing Examiner and the Secretary of Revenue's Final Decision adopting same are set forth in Appendices D and E, respectively, at 37a to 50a. The order of the Supreme Court of South Dakota denying reconsideration is set forth in Appendix F at 51a.

JURISDICTION

The Supreme Court of South Dakota issued its opinion on June 4, 2003, and denied Western's Petition for Rehearing on July 11, 2003. The Court has jurisdiction to issue a Writ of Certiorari pursuant to 28 U.S.C. § 1257(a).

CONSTITUTIONAL PROVISION INVOLVED

The Commerce Clause of the Constitution of the United States (art. I, § 8, cl. 3) is set forth in Appendix G, along with the pertinent provisions of the South Dakota Codified Laws at 52a to 54a.

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[2] *See* note 9, *infra*.

STATEMENT OF THE CASE

This petition seeks review of a state court decision upholding a tax imposed on a deemed "use" of services performed entirely outside the taxing state. Whether a facially discriminatory use tax (on services performed *outside* the taxing state) can be justified as compensating for a sales tax on services performed in the state is an important constitutional question the Court has not addressed. The extraterritorial imposition of use tax on services performed out of state is an important and increasingly frequent issue that exposes interstate commerce to significant risks of multiple taxation. If left uncorrected, this case sets a precedent for excessive multiple and discriminatory taxation among the numerous states expanding their sales and use taxes to ever more services.

South Dakota's Tax Scheme

Like an increasing number of states, South Dakota imposes sales and use taxes on the sale/use of many services (in addition to the traditional imposition of tax on the sale/use of tangible personal property).

Services performed in South Dakota are subject to sales tax, unless the service is "used *entirely* outside the state." S.D. Codified Laws § 10-45-4 and § 10-45-12.3 (emphasis added). Services performed outside South Dakota are subjected to South Dakota's use tax when the service is deemed to be "used" in the state. S.D. Codified Laws § 10-46-2.1.[3] No act by the taxpayer in South Dakota is necessary

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[3] South Dakota separately imposes use tax on the use of tangible property in South Dakota. S.D. Codified Laws § 10-46-2. Although Western's billing service provider mailed bills from California to addresses in many states the Department and the state courts emphasized that Western was *not* taxed on any purported use of the bills (as tangible property) in South Dakota. Rather Western was taxed on a deemed "use" of the billing *services*. *See* App. 6a-7a, 25a-26a, and 46a ("the services of CSC, which are utilized by Western are subject to use tax").

to constitute "use" of the service and trigger the use tax. The measure of the tax is the "*value* of the services at the time they are rendered." *Id.* (emphasis added).

The Billing Services and the Tax

Western's principal place of business is in suburban Seattle. Western provides cellular telephone service in a number of states, including South Dakota. As part of its cellular telephone business, Western has contracted with Computer Sciences Corporation ("CSC") for CSC to prepare and mail subscriber telephone bills from raw call data.

In Illinois, CSC takes raw call data provided by Western and converts the data into electronic telephone bills, a process referred to as "call rating."[4] CSC then transmits the bill images electronically from Illinois to a printer in California, where paper copies of the bills are printed and deposited in the U.S. mail to Western's subscribers (including those in South Dakota).

Western's customers remit payment to Phoenix. Billing questions are fielded by call centers located in Washington and New Mexico.

Western pays sales tax on the cellular telephone services it provides to South Dakota subscribers. S.D. Codified Laws § 10-45-6.1.[5] In addition to that tax, South Dakota has imposed use tax against Western on billing services performed by CSC in Illinois and California.

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[4] Western, at its offices in Washington State, reviews the electronic bills on a sampling basis.

[5] Western's cellular telephone business is also subject to numerous other taxes, including a state gross receipts tax, a state TRS surcharge and County E911 taxes.

Procedural History

Western challenged the tax assessment administratively, and the Department concluded that for use tax purposes "the beneficial use of every unit of billing information is in the state where the customer resides." App. 46a.

Western appealed the administrative decision to the Circuit Court, arguing that the out-of-state services were not subject to use tax and that imposition of use tax on out-of-state services violates the Commerce Clause. The trial court rejected Western's constitutional claims and affirmed the assessment, concluding that Western is deemed to "use" the services everywhere Western conducts its (separately taxable) business. In so holding, the court expressly distinguished between use taxes on tangible goods and use taxes on services, acknowledging that a use tax on goods requires that "a taxpayer must have some right or power incident to ownership of tangible personal property before such property is taxable." App. 26a. The court expressly rejected that requirement for imposing use tax on services: "the absence of that element of right or power is of no consequence in this case because that requirement is not necessary for the use taxation of *services*." *Id.*

In a 3-2 decision, the Supreme Court of South Dakota affirmed the Circuit Court's decision, and it denied Western's motion for reconsideration on July 11, 2003.

REASONS FOR GRANTING THE PETITION

The imposition of use taxes on out-of-state services presents a constitutional issue that the Court has not directly addressed, and it is important that the Court do so. Because the decision below conflicts with the Court's decisions addressing Commerce Clause restraints on state taxing powers, it is important that the Court address this form of tax in this case. Rule 10(c). This case presents a constitutional question affecting the validity of an increasingly widespread form of state taxation. The state court's decision establishes

a far-reaching precedent for other states to impose similar taxes on a deemed "use" of services performed out of state, thereby extending their taxing power to activities conducted outside their borders and subjecting taxpayers to significant risks of multiple taxation.

I. THIS CASE PRESENTS A CONSTITUTIONAL ISSUE OF SIGNIFICANT PUBLIC IMPORTANCE.

The impact of the decision below, and the potential economic harm resulting from states' taxing services performed in other states, is national in scope. The Federation of Tax Administrators ("FTA")[6] has undertaken several surveys examining the expanding trend toward state taxation of services, a trend it notes is driven by the "inexorable shift in consumer expenditures from the purchase of goods to the purchase of services." The FTA reports that between 1990 and 1992, 28 states expanded their sales taxes to cover more business services. From 1992 through 1996, ten states (including some of the earlier 28) made further expansions to cover additional business services. As the FTA concluded:

> Imposing sales tax on services will undoubtedly continue to be one of the most discussed topics in state tax policy in the coming years. As states try to arrest the erosion of the traditional sales tax base and meet increased demands, they will, by necessity, examine the taxation of the service sector.

FTA Research Report No. 147, Sales Taxation of Services, 1996 Update at 11 (Apr. 1997).

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[6] The FTA is the professional organization of state officials who administer tax laws.

Twenty states already impose sales and use taxes on a wide array of services.[7] So far 14 states (some not included above) impose sales and use taxes on information or data processing services like those at issue here.[8] Altogether, at least 34 of the 46 states that impose sales and use taxes now tax at least some types of business services. FTA Research Report No. 147 (Table 1). The increasing imposition of sales and use taxes on services has also been recognized by tax scholars. *See* Walter Hellerstein *et al.*, *Commerce Clause Restraints on State Taxation After Jefferson Lines*, 51 Tax L. Rev. 47, 103-04 (1995).

Texas, Maine and Virginia reflect the trend of expanding sales and use taxation of services. A resolution was recently introduced in the Texas Senate to amend the state's constitution to broaden that state's sales and use tax base. The resolution provides in relevant part that "[t]he state shall impose the [sales and use] tax described by Subsection (a) of this section on the sale or use of *all* services unless the legislature by general law provides exemptions from the application of the tax." SJR 1, § 8, 2003 Reg. Leg. Sess. 78 (Tex. 2003) (emphasis added). Similarly, a bill was introduced this year in Maine's House of Representatives that would radically expand Maine's definition of retail sales to include most major business, personal and licensed services. H 1020, §§ D-3 and D-8, 121st Maine Leg., Reg. Sess. (Me. 2003). In August, the Virginia Special Assembly's special commission on tax reform recommended

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[7] CCH, Inc., *U.S. Master Sales and Use Tax Guide* ¶ 126 (2002), identifies the sales and use taxation of services in the following 20 states as either "generally taxable" or "many taxable": Arizona, Arkansas, Connecticut, Florida, Hawaii, Iowa, Kansas, Maine, Mississippi, New Mexico, New York, Ohio, Oklahoma, Pennsylvania, South Dakota, Texas, Utah, Washington, West Virginia and Wisconsin.

[8] Connecticut, Delaware, Florida, Hawaii, New Mexico, New York, Ohio, Pennsylvania, Rhode Island, South Carolina, South Dakota, Texas, Washington and West Virginia. FTA Research Report No. 147, at 10.

legislation that would expand that state's sales and use taxes to "a wide range of services covering everything from auto repair to legal fees." BNA, Inc., *Daily Tax Report* No. 164 at H-1 (Aug. 25, 2003).

If left unaddressed, the decision below will be precedent encouraging other states to impose use taxes on out-of-state services. The Court should grant certiorari in this case to clarify for all states how Commerce Clause limitations on state taxing power apply to the imposition of use tax on services. *See Goldberg v. Sweet*, 488 U.S. 252 (1989) (certiorari granted to address Commerce Clause limitations on sales taxation of interstate telephone service in light of the proliferation of such taxes following deregulation).

II. THE STATE COURT'S OPINION CONFLICTS WITH LIMITATIONS ON STATE TAXING POWER IN THE COURT'S DECISIONS.

The hallmark of the Court's modern Commerce Clause jurisprudence has been an emphasis on the "practical effect" of a tax, rather than the "formal language of the tax statute." *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). In its emphasis on the practical effect of state taxes, the Court has focused on two related vices: (1) preventing taxation of extraterritorial activities, *ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982) (a state "may not tax value earned outside its borders"), and (2) protecting against the threat of multiple taxation, *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 182 (1995). These two practical concerns are the foundation of "what has come to be known as *Complete Auto's* four-part test." *Id.* at 183.

The Court has addressed the application of these principles to a variety of taxes,[9] but it has not yet considered

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[9] For example, *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996) (franchise tax on stocks); *Jefferson Lines*, 514 U.S. 517 (sales taxation of services);

their application to use taxes imposed on services, an area of rapidly increasing importance.

A. Taxes on a Deemed "Beneficial Use" of Out-of-State Services Are Not Valid Compensatory Taxes.

As the Court has noted, use taxes are by nature facially discriminatory, because they effectively apply only to out-of-state purchases. *Fulton Corp. v. Faulkner*, 516 U.S. 325, 332 (1996) (citing *Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937)). Under the Commerce Clause, facially discriminatory taxes are "virtually per se invalid." *Oregon Waste Sys. v. Department of Envtl. Quality*, 511 U.S. 93, 99 (1994). Thus, the Court's "cases require that justifications for discriminatory restrictions on commerce pass the 'strictest scrutiny.'" *Id.* at 101 (quoting *Hughes v. Oklahoma*, 441 U.S. 322, 337 (1979)).

In this context, "a facially discriminatory tax may still survive Commerce Clause scrutiny if it is a truly 'compensatory tax' designed to simply make interstate commerce bear a burden already borne by intrastate commerce." *Fulton*, 516 U.S. at 329 (quoting *Associated Indus. of Mo. v. Lohman*, 511 U.S. 641, 647 (1994)). Use taxes, when imposed on tangible property that is physically present in a state, have been upheld as valid compensatory taxes, provided that "the combined effect of the sales and use taxes was to subject intrastate and interstate commerce to equivalent burdens." *Fulton*, 516 U.S. at 332. *The Court has never addressed the potential expansion of the compensatory tax doctrine to use taxes imposed on out-of-state services.* Like the taxes the Court invalidated in *Fulton* and *Oregon Waste*, and contrary to the view of the court below, South Dakota's tax does not meet the requirements of the Court's compensatory tax doctrine.

Allied-Signal, Inc. v. Director, Div. of Taxation, 504 U.S. 768 (1992) (net income tax on dividends); and *Tyler Pipe Industries, Inc. v. Department of Revenue*, 483 U.S. 232 (1987) (gross receipts tax on sales of goods).

First, the Court has recognized that sales and use taxes *on tangible property* are taxes on "substantially equivalent events," reasoning that:

> The privilege of use is only one attribute, among many, of the bundle of privileges that make up property or ownership. ... A state is at liberty, if it pleases, to tax them all collectively, or to separate the faggots and lay the charge distributively ... [which] has no greater or different effect upon that commerce than a general property tax.

Silas Mason, 300 U.S. at 582 (citations omitted). There is no similar property right on which to ground a use tax on services performed outside the state but assumed to be "used" in every state where the taxpayer's multistate business extends (especially when, as in this case, the taxpayer's business is already subject to a sales tax, the absence of which is the only justification for the use tax). By analogy, Western owns telephone switches in states outside South Dakota that transmit calls made by South Dakota subscribers, yet does not exercise any property rights over those switches in South Dakota; that state cannot impose use tax on switches that never enter the state merely because they are components of an interstate business conducted in part with South Dakota customers.

Put another way, any deemed benefit to Western's telephone business in South Dakota is not "sufficiently similar in substance to serve as [a] mutually exclusive 'prox[y]'" for CSC's data processing and printing activities performed in Illinois and California. *Oregon Waste*, 511 U.S. at 103 (quoting *Armco Inc. v. Hardesty*, 467 U.S. 638, 643 (1984)). As the Court has emphasized "our more recent cases have shown extreme reluctance to recognize new compensatory categories. In *Oregon Waste* we even pointed out that 'use taxes on *products* purchased out of state are the *only* taxes we have upheld in recent memory under the

compensatory tax doctrine.'" *Fulton*, 516 U.S. at 338 (quoting *Oregon Waste*, 511 U.S. at 105) (emphasis added).

B. A Use Tax on Intangible Benefits From Out-of-State Services Exposes Interstate Business to a Risk of Multiple Taxation Expressly Prohibited by the Court's Decisions.

The Court has instructed that an impermissible threat of multiple taxation exists

> whenever one State's act of *overreaching* combines with the possibility that another State will claim its fair share of the value taxed: the portion of value by which one State exceeded its fair share would be taxed again by a State properly laying claim to it.

Jefferson Lines, 514 U.S. at 184-85 (emphasis added). The tax in this case suffers from that vice. South Dakota has overreached state boundaries by imposing tax on the value of services performed in Illinois and California.[10]

In *Jefferson Lines*, the Court addressed a Commerce Clause challenge to sales tax on bus tickets purchased in the state for outbound interstate travel. The Court explained that it has upheld taxes on sales of *goods* against Commerce Clause challenges because a "sale of goods is most readily viewed as a discrete event facilitated by the laws and amenities of *the place of sale*." 514 U.S. at 186 (emphasis added). Thus, there is "a sufficient safeguard against the risk of multiple taxation of a sale in the fact that it was consummated in only one State." *Id.* at 187. Consequently, "a sales tax on coal, for example, could not be repeated by

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[10] The Court has decried such overreaching as a violation of *Complete Auto*'s fair apportionment requirement. *Id.* at 184. It also violates *Complete Auto's* substantial nexus requirement. *Goldberg v. Sweet*, 488 U.S. 252 (1989).

other States, for the same coal was not imagined ever to be delivered in two States at once." *Id.*

The Court concluded in *Jefferson Lines* that a "sale of services can ordinarily be treated as a local state event just as readily as a sale of tangible goods can be located solely within the State of delivery." *Id.* at 188. The Court then found that Oklahoma had a unique relationship to service being taxed:

> The taxable event comprises agreement, payment, and delivery of some of the services in the taxing State; no other State can claim to be the site of the same combination.

Id. at 190. In *Goldberg*, the Court applied the same analysis to a sales tax on landline telephone services that originated or terminated in the state. By limiting the tax to calls that (1) originate or terminate in the state and (2) are charged or billed to a location in the state, the tax was imposed only on *activities conducted within the state* and avoided a risk of multiple taxation. 488 U.S. at 262-63 (call's origination and termination points defined the "only two States [that] have a nexus substantial enough to tax" the service).

Applying the Court's *Jefferson/Goldberg* standard to the South Dakota tax on billing services spotlights the prohibited threat of multiple taxation. *Goldberg* and *Jefferson Lines* identified two characteristics that protected the taxpayers in those cases from the threat of multiple taxation. First, a key part of the taxed service was performed in the taxing state (where the bus trip or phone call either originated or terminated). Second, the taxed service was either paid for in the taxing state or billed to the taxpayer's location there. These protections are not present in South Dakota's scheme for taxing a deemed "use" of services performed entirely outside the state.

Contrary to the tax on phone service in *Goldberg*, or the phone services on which Western already pays South Dakota sales tax, or the bus service in *Jefferson Lines*, no part of CSC's billing service was performed in South Dakota, nor was CSC's service billed to or paid for in South Dakota. CSC bills Western for that service at Western's corporate headquarters in Washington State, the same state where Western pays for the service.

Unlike *Goldberg* and *Jefferson Lines* (where the significant local activities precluded any other state from taxing the same transaction), Illinois and California clearly have the power to tax CSC's performance of these services in their states. *See Jefferson Lines*, 514 U.S. at 188 ("we have held that the entire gross receipts derived from sales of services to be performed wholly in one state are taxable by that State").

C. South Dakota's Taxation of Services Performed Entirely Outside the State Is Extraterritorial Taxation, Prohibited by the Court's Decisions.

Taxation of a deemed "use" in one state of intangible benefits from a service actually performed in another state has the practical economic effect of allowing state taxation of extraterritorial activity. The Commerce Clause prohibition against taxing value earned from activities conducted outside a state's borders "focuses on the guidelines necessary to circumscribe the reach of the State's legitimate power to tax" –in particular on "the basic principle that the State's power to tax an individual's or corporation's activities is justified by the 'protection, opportunities and benefits' the State confers on *those activities*." *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768, 778 (1992) (emphasis added)

(quoting *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940)).[11]

As discussed above, South Dakota already taxes the cellular phone services Western provides in South Dakota, for which the state undisputedly provides protection and benefit. South Dakota, however, does not confer any protections or benefits to the activities of CSC in performing billing services for Western in Illinois and California; thus there is no justification for South Dakota to impose tax on those extraterritorial activities.

CSC does not perform any part of its billing services in South Dakota; those services begin with call rating in Illinois and end with bill printing and mailing in California. South Dakota has taxed surreptitiously that which it is prohibited from taxing directly.

Simply put, the state has taxed services performed entirely outside its boundaries by labeling the tax as one on "use" and then "deeming" the service to be "used" in South Dakota, where Western performs a separately taxed activity (providing cellular phone service). Permitting South Dakota to accomplish by stealth and labels that which it is forbidden to do directly would resurrect the formalism the Court expressly rejected in *Complete Auto Transit*.

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[11] The prohibition is grounded both in "the requirement that, in the case of a tax on an activity, there must be a connection to the activity itself, rather than a connection only to the actor the State seeks to tax," *id.* (citing *Quill Corp. v. North Dakota*, 504 U.S. 298, 306-08 (1992)), as well as concern for the risk of multiple taxation that would result from "overreaching" and taxing extraterritorial activities:

> In a Union of 50 States, to permit each State to tax activities outside its borders would have drastic consequences for the national economy, as businesses could be subject to severe multiple taxation.

Id. at 777-78.

While apparent on its face, the extraterritorial nature of the tax may also be illustrated by hypothetical examples:

1. Assume that Western did not outsource the billing function and instead purchased a computer it installed in Illinois and a printing press it installed in California to do the billing (the same billing services Western purchased from CSC). It is beyond question that South Dakota could not impose use tax on the computer and printing press because Western never used the property in South Dakota.

2. Similarly Western owns switching equipment in various states that it uses to provide its interstate cellular phone service. South Dakota can impose sales or use tax on the two switches actually located in that state, but not on switches located in other states, even if they are used in providing phone service to its South Dakota customers.

3. A company doing business in multiple states hires a law firm in Chicago to provide legal advice. The advice relates broadly to the company's overall operations and therefore its business in every state. Under South Dakota's scheme the service is subject to South Dakota tax to whatever extent South Dakota deems the legal services used there.

These hypotheticals are not purely theoretical, the breadth of South Dakota's use tax on out-of-state services is virtually limitless. The state court affirmed the application of use tax on the deemed "use" in South Dakota of accounting services performed in Arizona. *In re Thermoset Plastics, Inc.*, 473 N.W.2d 136 (S.D. 1991). In *Thermoset*, South Dakota imposed use tax on accounting fees a start-up business paid for accounting services performed in Arizona. Those services involved creating a projection of potential cash flows for "a different product line, different manufacturing equipment, and a different labor structure than what later materialized in South Dakota." *Id.* at 137. Moreover, the services were performed when the company "had not yet determined that it would locate in South Dakota." *Id.*

The Court has not yet considered the application of its Commerce Clause principles to use taxes imposed on services performed outside the taxing state, a widespread and increasingly popular form of state taxation. The state court's decision, approving the tax, conflicts with the guiding principles in the Court's cases establishing limitations on state taxing power, including (a) the requirements for justifying facially discriminatory taxes as compensatory; (b) the prohibition against taxes that expose interstate businesses to the risk of multiple taxation; and (c) the prohibition against taxing value created outside a state's borders. Both the states and business will benefit from the Court's clarification of the constitutional scope of the states' power to impose use tax on services performed outside their boundaries.

CONCLUSION

For the reasons set forth above, Western respectfully requests that the Court grant certiorari to review the Supreme Court of South Dakota's decision.

Respectfully submitted,

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October 9, 2003

Appendix A

SUPREME COURT OF SOUTH DAKOTA

WESTERN WIRELESS CORPORATION, AND SIOUX FALLS CELLULAR COMMUNICATIONS CORPORATION,
Plaintiffs and Appellants,

v.

DEPARTMENT OF REVENUE,
Defendant and Appellee.

No. 22373

Decided June 4, 2003

KONENCAMP, J. (on reassignment). – South Dakota imposes a use tax on tangible personal property and services purchased out of state for in-state use. The question here is whether the Department of Revenue properly levied use tax on out-of-state billing services purchased by a South Dakota cellular phone company to bill and collect fees from its South Dakota subscribers. Both the hearing examiner and the circuit court concluded that the use tax was properly collectible. Because this billing service applies to activities of the purchaser in this state and the amount of tax is apportioned to the billing service applicable to South Dakota customers, our statutes authorize use tax on this service and they are constitutional. We affirm.

A. Background. Western Wireless operates a cellular telephone business in South Dakota. Although its principal office is in the State of Washington, it has physical facilities in both Sioux Falls and Rapid City. To provide its South Dakota customers a monthly billing statement for cellular services, Western contracts with Computer Sciences Corporation (CSC) in Champaign, Illinois, to obtain

"subscriber billing services." For these services, Western pays an undisclosed fee.[1] Western records the cellular activity of its South Dakota customers on its equipment in South Dakota. Western then sends the recorded information to CSC in Illinois. Using its proprietary software, CSC runs the raw data on these tapes through a "call rating process" to generate electronic bills.

The electronic bills are then sent to a Western office in Washington for approval. Once approved, CSC sends them to a subcontractor in California, where invoices are printed. The invoices are placed in the United States mail in California, eventually reaching Western's South Dakota customers. All payments made on bills are remitted to Phoenix, Arizona. Customer questions about the bills are handled in Washington or New Mexico. In short, the essential information necessary to complete the bills originates from Western Wireless in South Dakota, and, after processing by the billing service contractor, the bills are mailed to South Dakota subscribers.

Upon a tax audit of Western's operations, the Department sought to collect $232,408.12 for use tax on the billing services applicable to Western's billings in South Dakota from 1994 to 1997. Western challenged the assessment. The hearing examiner ruled that the tax was proper. On appeal to the circuit court, it initially reversed the decision. Later, following a remand for further evidentiary findings, the court ruled that the billing services were subject to use tax and that the imposition of the tax was constitutional. On appeal before us, Western asserts that South Dakota's legislative framework does not impose use

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[1] Western declined the Department's request for information to determine what Western pays for this service. Therefore, the Department obtained outside information to calculate the per customer rate for the billing service.

tax on the billing services and that if it did, such tax would be unconstitutional.[2]

B. Standard of Review. This is an administrative appeal. We reconfirmed the proper standard of review for administrative appeals in Sopko v. C & R Transfer Co., Inc., 1998 SD 8, ¶¶ 6-7, 575 NW2d 225 , 228-29 . SDCL 1-26-36 requires us to give great weight to administrative findings and inferences on factual questions. *Id.* ¶ 6. Agency findings are examined "in the same manner as the circuit court to decide whether they were clearly erroneous in light of all the evidence. If after careful review of the entire record we are definitely and firmly convinced a mistake has been committed, only then will we reverse." *Id.* An agency's conclusions of law, however, are fully reviewable. *Id.* Tax statutes are construed liberally in favor of the taxpayer, as are ambiguities in those statutes. Nash Finch Co. v. South Dakota Dep't of Revenue, 312 NW2d 470, 472 (SD 1981) . Because the questions here are primarily legal ones, our review in this case is de novo.

C. Use Tax on Out-of-State Billing Services. Sales tax is a transaction tax on certain sales and services occurring in South Dakota. Use tax serves as a sales tax substitute imposed on those who buy out of state and do not pay sales tax. The levy of the use tax attaches after the use of a tangible item or service occurs in South Dakota. *See generally* Billings v. United States, 232 U.S. 261 , 34 SCt 421, 58 LEd 596 (1914) . The two taxes are mutually compensating, one supplementing the other, but both cannot be equally applicable to the same transaction. The rate of tax is the same. *See generally* SDCL ch 10-45, 10-46.

Use taxes accommodate two vital concerns: (1) the state may lose tax revenue if taxpayers purchase out-of-state goods

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[2] The audit also resulted in additional use tax on certain equipment owned by Western. Western did not dispute that tax.

or services for in-state use, and (2) local providers will lose business if taxpayers purchase out-of-state goods or services to avoid sales tax liability. Northwestern Nat'l Bank of Sioux Falls v. Gillis, 82 SD 457, 467 , 148 NW2d 293, 298 (1967) ; *see generally* Jerome R. Hellerstein & Walter Hellerstein, 2 State Taxation § 16.01[2] (3d ed 2000). Thus, the Legislature imposes a sales tax on purchases of goods and services within the state and a complementary use tax on goods and services purchased outside the state for use within the state. By itself, a use tax may appear to be discriminatory because it applies only to goods and services acquired out of state. Halliburton Oil Well Co. v. Reily, 373 U.S. 64, 69 , 83 SCt 1201, 1203 , 10 L.Ed.2d 202 (1963) . Nonetheless, because use taxes are paired with complementary sales taxes, the United States Supreme Court has upheld them: in the context of the overall tax structure, such statutes may properly impose on the out-of-state purchase of goods an equivalent burden to that imposed on an in-state purchase. Henneford v. Silas Mason Co., 300 U.S. 577 , 57 SCt 524, 81 LEd 814 (1937) .

To support imposing use tax on the billing services Western purchases, the Department relies on SDCL 10-46-1(13) and 10-46-2.1 (use tax on services).[3]

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[3] SDCL 10-46-2.1:

> For the privilege of using services in South Dakota, except those types of services exempted by § 10-46-17.3 , there is imposed on the person using the service an excise tax equal to four percent of the value of the services at the time they are rendered....

SDCL 10-46-1(13):

> "Use," the exercise of right or power over tangible personal property incidental to the ownership of that property, except that it does not include the sale of that property in the regular course of business. Use also includes the use of the types of services, the gross receipts from the sale of which are to be included in the measure of the tax imposed by chapter 10-45,

Under SDCL 10-46-1(13), the term "use" "also includes the use of the types of services, the gross receipts from the sale of which are to be included in the measure of the tax imposed by chapter 10-45...." Turning to chapter 10-45, we see that the term "service" means "all activities engaged in for other persons for a fee, retainer, commission, or other monetary charge, which activities involve predominantly the performance of a service as distinguished from selling property." SDCL 10-45-4.1.

Western contends that no use tax is payable because of our decision in Modern Merchandising, Inc. v. Department of Revenue, 397 NW2d 470, 471 (SD 1986) . In that case, this Court reversed the imposition of use tax on the cost of LaBelle's catalogs and flyers mailed to South Dakota residents. LaBelle's sold goods by mail order and through its local stores. The materials were delivered to South Dakota by mail or by common carrier. They were sent by out-of-state printers who contract with LaBelle's to produce these flyers and catalogs. LaBelle's provided South Dakota addresses where the materials were to be delivered.

In *Modern Merchandising,* the Department argued that LaBelle's used "the flyers and catalogs to generate sales in South Dakota and to operate its catalog business." In rejecting this argument as a basis for levying use tax, we found that LaBelle's had no in-state contract for the services and all control over the flyers and catalogs in South Dakota vested in either the post office or the recipients. We held that the Department's focus on whether the materials generated sales to support a use tax was erroneous; instead, the inquiry

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and any amendments thereto and the delivery or causing delivery into this state of tangible personal property intended to advertise products or services or promote or facilitate sales to South Dakota residents.

should turn on whether the language of the taxing statutes applied.[4]

Western asserts that, as in *Modern Merchandising,* no use tax applies here because it "has contracted for the printing of [its] bills by a third party, and as a result Western does not generate, print, or mail the bills to in-state residents; the bill preparer/printer controls all of these functions and the bills themselves." Western equates these "tangible itemized written bills" with the advertising materials sent to South Dakota residents. Moreover, Western points out that even the amended language in SDCL 10-46- 1(13), added in response to the *Modern Merchandising* decision, will not encompass these transactions because the invoices do not "advertise products or services or promote or facilitate sales to South Dakota residents." Western believes that there is an insufficient nexus between the cost of producing the billing statements and South Dakota to justify use tax and, therefore, the billing service is outside the statutory reach of the tax.

Modern Merchandising dealt with whether a merchandiser had sufficient right or power incidental to ownership of advertising materials sent from out of state to qualify as a use in this state of tangible personal property. 397 NW2d at 472-73; *see* SDCL 10-46-1(2) and 2. On the other hand, our decision in Thermoset Plastics, Inc. v. Department of Revenue, 473 NW2d 136 (SD 1991) addressed the in-state use of out of-state services. The service in that case was provided by an out-of-state accounting firm to a South Dakota business. Before commencing operations in South Dakota, Thermoset incurred $8,000 in fees for the preparation of a cash flow statement by the Arthur Andersen

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[4] Following the decision in *Modern Merchandising,* the Legislature altered the definition of "use" to include "the delivery or causing delivery into this state of tangible personal property intended to advertise products or services or promote or facilitate sales to South Dakota residents." 1987 SDSessL ch 108, § 1. This change is now codified in SDCL 10-46-1(13).

accounting firm in Phoenix, Arizona. In holding that the cost of the cash flow statement was subject to use tax in South Dakota, we wrote: "Thermoset used these accounting services in South Dakota to conduct its business and is therefore subject to use tax on these services." Id. at 139. In sum, the out-of-state accounting service directly applied to *Thermoset's* activities in this state and thus use tax was properly assessed.

The relevant definition of "use" in SDCL 10-46-1(13) states that "Use also includes the use of the types of *services,* the gross receipts from the sale of which are to be included in the measure of the tax imposed by chapter 10-45...." (Emphasis added.) *See* SDCL 10-46-2.1. Here, the Department is not seeking to tax the purchase and use of tangible personal property. Yet, Western wishes us to view the billing service as simply the printing and mailing of tangible invoices, apart from the essential service it purchases. Western reasons that no use tax applies because it does not "generate, print or mail the bills," and the bills "do not generate sales," do not contain "advertising materials," and have no "information to facilitate sales." That analysis, from *Modern Merchandising,* applies to the out-of-state purchase of tangible personal property, i.e., advertising materials, for use in South Dakota. If the same analysis applies to services, then *Thermoset Plastics* was wrongly decided. There, the out-of-state accounting bill for services that we held was subject to use tax did "not generate sales," did not contain "advertising materials," and had no "information to facilitate sales," and moreover, *Thermoset* did "not generate, print or mail the bills" for the out-of-state accounting services.

Our analysis in *Thermoset* applies to these circumstances. As in *Thermoset,* Western uses the billing service "in South Dakota to conduct its business and is therefore subject to use tax on these services." Thermoset,

473 NW2d at 139 . What is involved here is more than merely the arranging for paper invoices to be mailed to South Dakota residents. This activity is predominantly the performance of a service. SDCL 10-45-4.1. As the circuit court aptly phrased it, "there can be no dispute that billing customers is a necessary part of conducting a cellular telephone business." Unquestionably, if this billing service were provided by a South Dakota based company, it would be required to collect sales tax on its fees. *See* SDCL 10- 45-4.1. Union Pacific R.R. Co. v. Auditing Div. of Utah State Tax Comm'n, 842 P.2d 876 (Utah 1992) . Use tax is compensatory or complementary to sales tax. Western uses an out-of-state billing service to collect its fees from its South Dakota subscribers. Only those billing services specifically attributable to South Dakota customers are subject to the tax. This service is an integral part of Western's business in South Dakota. Indeed, there would be no business without it. We uphold the imposition of use tax.

D. Constitutionality of Use Tax. Western next contends that because this billing service is rendered by an out-of-state contractor, South Dakota's imposition of use tax here is a burden on interstate commerce. To determine if this tax is unconstitutional, we look to the Supreme Court's decision in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 97 SCt 1076, 51 L.Ed.2d 326 (1977) . A tax is not an unconstitutional burden on interstate commerce if the taxed activity is sufficiently connected to the state to justify the tax, the tax is fairly related to benefits provided to the taxpayer, the tax does not discriminate against interstate commerce, and the tax is fairly apportioned. The use tax here passes these tests. Id. at 287, 97 SCt at 1083.

South Dakota has a substantial nexus with the taxed activity. Western provides cellular telephone service to its South Dakota subscribers. It owns communications equipment and conducts business in South Dakota. It employs personnel in South Dakota to install and maintain the equipment.

Electronic statistics on subscriber usage are transferred from South Dakota, where it originates, to Western's billing service contractor who, in turn, arranges for the South Dakota customers to receive bills for their usage.

Equal treatment for in-state and out-of-state transactions similarly situated is a prerequisite to a valid use tax on goods and services imported from out-of-state. Halliburton, 373 U.S. at 70, 83 SCt at 1204 . South Dakota's use tax on services will apply to the use of a taxable service purchased inside or outside this state when the primary benefit of the service is used or consumed in this state and, at the time of purchase, sales tax was not imposed. This use tax is fairly related to state-provided services because Western has the right and benefit of selling its services to South Dakota residents. The use tax does not discriminate against interstate commerce because the tax compensates the state for sales tax imposed on similar in-state transactions. D.H. Holmes Co., Ltd. v. McNamara, 486 U.S. 24 , 108 SCt 1619, 100 L.Ed.2d 21 (1988) . Finally, the tax is fairly apportioned because (1) the services taxed are only those attributable to the billing of South Dakota subscribers, and (2) our law provides a credit against use tax for transactions in which a sales tax was paid in other states. SDCL 10-46-6.1.

The fair-apportionment analysis was employed by the *Supreme Court in* Goldberg v. Sweet, 488 U.S. 252, 109 SCt 582, 102 L.Ed.2d 607 (1989) . There, the Court held that the tax must be internally and externally consistent. To be externally consistent under *Goldberg,* a state may tax "only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed." Id. at 262, 109 SCt at 589. South Dakota's use tax reasonably reflects the way that Western uses this service. It receives the service in South Dakota when its South Dakota customers are billed for their cellular usage. The primary benefit of the service is used or consumed here. "To

be internally consistent, a tax must be structured so that if every State were to impose an identical tax, no multiple taxation would result." Id. at 261, 109 SCt at 589.—Here, if every state taxed the billing service attributable only to that state's customers, as South Dakota does, only one state, the state where that service was provided, would tax the transaction. Further, as mentioned above, South Dakota allows a credit for sales taxes paid to other states. Under *Goldberg,* this credit provision avoids actual multiple taxation, and, thus, the tax does not threaten interstate commerce.

It is true that, as Western points out, our law allows no credit for taxes paid in another state where that state "does not reciprocally grant a credit for taxes paid on similar tangible personal property." SDCL 10-46- 6.1 . Assuming this statute applies to services the same as it does to tangible personal property, then this conditional reciprocity could present a problem in the future. It is critical, as the Supreme Court acknowledges, that these statutory "credit provisions create a national system under which the first state of purchase or use imposes the tax. Thereafter, no other state taxes the transaction unless there has been no prior tax imposed ... or if the tax rate of the prior taxing state is less, in which case the subsequent taxing state imposes a tax measured only by the differential rate." Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 194, 115 SCt 1331, 1343, 131 L.Ed.2d 261 (1995) (quoting KSS Transportation Corp. v. Baldwin, 9 NJ Tax 273, 285 (1987)). However, Western does not assert that any sales or use taxes have been paid on all or part of these services in any other state nor has it sought any credit for payment of such taxes. Under these circumstances, therefore, the point is moot.

Affirmed.

GILBERTSON, Chief Justice, and SABERS, Justice, concur.

MILLER and AMUNDSON, Retired Justices, dissent.

DISSENTING OPINION

MILLER, Retired Justice (dissenting). – The majority opinion misconstrues the definition of "use" as that term has been legislatively defined and interpreted by the prior precedent of this Court. I agree with the majority opinion's recognition that the use tax is aimed to remedy concerns that the state may lose tax revenue if taxpayers purchase out-of-state goods or services for in-state use and that local providers will lose business if those out of state purchases avoid tax liability. However, those concerns cannot justify the imposition of a tax unless that tax is clearly articulated in the statutory framework. As the following discussion demonstrates, the state's remedy is legislative and not judicial.

The imposition of a use tax on the billing services is legally and factually unsupported.

In support of its assertion supporting imposition of the use tax Department relies upon the following statutory provisions:

> *10-46-2.1. Use tax—Tax imposed on use of services—Exemptions—"Related corporation" defined.* For the privilege of using services in South Dakota, except those types of services exempted by § 10-46-17.3 , there is imposed on the person using the service an excise tax equal to four percent of the value of the services at the time they are rendered. However, this tax may not be imposed on any service rendered by a related corporation as defined in subdivision (11) of § 10-43-1 for use by a financial institution as defined in subdivision (4) of § 10-43-1 or on any service rendered by a financial institution as

> defined in subdivision (4) of § 10-43-1 for use by a related corporation as defined in subdivision (11) of § 10-43-1. For the purposes of this section, the term related corporation includes a corporation which together with the financial institution is part of a controlled group of corporations as defined in 26 USC § 1563 as in effect on January 1, 1989, except that the eighty percent ownership requirements set forth in 26 USC § 1563(a)(2)(A) for a brother-sister controlled group are reduced to fifty-one percent. For the purpose of this chapter, services rendered by an employee for the use of his employer are not taxable.
>
> SDCL 10-46-1(13) *Use,* the exercise of right or power over tangible personal property incidental to the ownership of that property, except that it does not include the sale of that property in the regular course of business. Use also includes the use of the types of services, the gross receipts from the sale of which are to be included in the measure of the tax imposed by chapter 10-45, and any amendments thereto and the delivery or causing delivery into this state of tangible personal property intended to advertise products or services or promote or facilitate sales to South Dakota residents.

Western counters asserting that the use tax law contains an inherent limitation requiring the use of the billing services to occur in the State of South Dakota. Western also argues that the billing services and the statements produced constitute personal property and not services for tax purposes. On these facts, Western argues that there is an insufficient nexus between the cost of producing the billing statements and the State of South Dakota to justify use tax.

Both parties assert that prior use tax decisions of this Court are dispositive.

In *Thermoset Plastics, Inc. v. Department*, 473 NW2d 136 (SD 1991) , this Court addressed a use tax assessment for services provided by an out-of-state accounting firm to a South Dakota corporation. Prior to commencing operations in South Dakota, Thermoset incurred $8,000 in fees for the preparation of a cash flow statement by the Arthur Anderson accounting firm in Phoenix, Arizona. In holding that the cash flow statement was subject to use tax in South Dakota, the Court stated:

> Thermoset's transaction with Arthur Anderson is subject to tax under SDCL 10-46-2.1. Although some of Arthur Anderson's services may have become obsolete when the designs of various plates were changed, some of the machinery included in the study is still being used in South Dakota. Further even if these plate designs are obsolete now, they were not obsolete at the time the services were rendered. Thermoset used these accounting services in South Dakota to conduct its business and is therefore subject to use tax on these services.

Id. at 139.

In that case, the record revealed that items of equipment examined in the cash flow statement were a product line being used in South Dakota. Therefore, there was a link between the out-of-state service and the sale of products with a resulting use in South Dakota by Thermoset. Department therefore claims that because billing services are a necessary part of Western's business in South Dakota this rationale is applicable to support a use tax on the cost of those services provided outside South Dakota.

To the contrary, Western relies upon our decision in Modern Merchandising, Inc. v. Department, 397 NW2d 470 (SD 1986) , to assert the inapplicability of the use tax. In *Modern Merchandising,* this Court reversed the imposition of use tax for the cost of catalogs and flyers mailed to South Dakota residents by LaBelle's Corporation. LaBelle's retailed consumer goods by mail order and through stores located in Minnesota, North Dakota and South Dakota. The materials were printed in Minnesota and delivered to South Dakota by mail or through a common carrier by out-of-state printers contracted by LaBelle's to provide these flyers and catalogs. LaBelle's only involvement was providing the South Dakota addresses of where the literature was to be delivered. Id. The issue on appeal was whether "LaBelle's had sufficient right or power incidental to the ownership of the catalogs and flyers once in South Dakota to qualify as a use in this State under SDCL 10-46-1(2) and 2."

In *Modern Merchandising,* Department argued that Labelle's used "the flyers and catalogs to generate sales in South Dakota and to operate its catalog business" to justify imposition of the use tax. *Id.* at 471. Rejecting this argument, the Court recognized that LaBelle's had no in-state contract for these services and all control over the flyers and catalogs in South Dakota vested in either the post office or item recipients. ("Department concentrated more on the material's generation of in-state sales for LaBelle's than on whether LaBelle's activities fit the language of the tax statutes.") Furthermore, the Court rejected Department's policy argument that use tax was applicable if by not imposing the tax our in-state retailers would be at a disadvantage when compared to out-of-state competitors and that if a local entity must pay a tax then so should the outside entity providing the same services. We have recognized "that not only was the use tax intended to raise money but it was also intended to help the retailers in this state, who are subject to the sales tax, compete on an equal footing with out-of-state competitors."

Northwestern Nat'l Bank of Sioux Falls v. Gillis, 82 SD 457, 467, 148 NW2d 293, 298 (1967) . We must remember, however, that despite the legislative intent, this Court cannot rewrite a taxing statute based on arguments of a competitive disadvantage that purportedly occurs as a result of the statutory framework or a perceived unfairness. The Court in *Modern Merchandising* observed: "While we agree with Department's interpretation of our legislature's intent, we cannot apply the statute to activity which is plainly alien to its language. We must honor the rule that statutes imposing a tax are to be construed liberally in favor of the taxpayer." Modern Merchandising, supra at 472 . Though Department's concerns may have been valid, "this contention is more appropriately directed to the legislature."

Following the decision in *Modern Merchandising,* the legislature altered the definition of "use" to state that "the delivery or causing delivery into this state of tangible personal property *intended to advertise products or services or promote or facilitate sales to South Dakota residents* " constitutes a "use" within the meaning of the legislative framework. (emphasis added). 1987 SD SessL ch 108, § 1. This change is now codified at SDCL 10-46-1(13) . While the *Modern Merchandising* holding has thus been abrogated by the legislature, the holding's reasoning is still valid: Department cannot exceed its statutory grant of authority.

The majority opinion's flaw is best demonstrated by comparing this situation to another case where use tax was found to be proper, Quotron Systems, Inc. v. Limbach, 584 N.E.2d 658 (Ohio 1992) . In *Quotron,* the Ohio Supreme Court determined that use tax was appropriately imposed on a computer service that provided access to computer equipment enabling subscribers in Ohio to examine or acquire data stored by that system out of state. *Id.* at 659. However, the relevant Ohio taxing authority specifically imposed tax upon automatic data processing and computer

services. *Id.* Furthermore, the Ohio court quotes the following from the Ohio legislative pronouncements:

> R.C. 5739.01 defined automatic data processing and computer services, until January 10, 1985, to include 'providing direct access to computer equipment by remote or proximate access for the purpose of processing data or examining or acquiring data stored in or accessible to such computer equipment,' and after this date, to include 'providing access to computer equipment for the purpose of processing data or examining or acquiring data stored in or accessible to such computer equipment.'

Consequently, the Ohio court determined the taxing statutes applied to the data processing services and that use tax was properly imposed. *Id.* In comparing that taxing authority with the statutes relied upon by Department the Ohio statutory authorization for imposing the use tax on data processing and computer services is clearly more sophisticated and direct than that relied upon by the Department here. This is fatal to Department's argument. The statutory authorization for collection of use tax is to be construed liberally in favor of the taxpayer, however, the majority opinion misconstrues the taxing authority liberally in favor of the Department.

Under our system the predicate for use tax under SDCL 10-46-2.1 is "using services in South Dakota" that are non-exempt. Western has contracted for billing services with an out-of-state third party. Western itself does not generate, print or mail the bills to South Dakota residents. When the bills arrive in South Dakota they are controlled by the United States mail or the customers receiving the bills. While Western's bills serve the purpose of providing its customers with information concerning their account, the billing services do not themselves generate sales. There are no facts establishing that these billing statements contain advertising

materials or information to facilitate sales as part of the billing service. In this situation, the sale of cellular service is already complete when the billing statements arrive to the South Dakota customer. A billing statement for services previously rendered clearly is not something delivered "to advertise products or services or promote or facilitate sales." Comparing the billing services with the catalogs and flyers at issue in *Modern Merchandising* and the accounting services in *Thermoset,* the billing services more closely resemble the catalogs and flyers in *Modern Merchandising.*

The circuit court attempted to distinguish the *Modern Merchandising,* holding by asserting its result was controlled by SDCL 10-46-2 and not SDCL 10-46-2.1, upon which Department now relies. However, both statutory provisions are governed by the definition of "use" provided in SDCL 10-46-1(13). The circuit court determined that "although each individual component of that billing service was produced in other states, the completed billing service was acquired for 'use' in South Dakota to bill [Western's] South Dakota customers and to conduct [Western's] South Dakota cellular telephone business." While Department urged, and the circuit court found, the billing services as a whole constituted a "use" in South Dakota, this expansive view of Department's taxing authority is contrary to the dictate that we narrowly construe the taxing authority. Clearly, the circuit court characterized the "complete billing service" as a taxable event because the bills inevitably entered the state through the mail and arrived where Western directed. However, this is contrary to the rationale set forth in *Modern Merchandising,* which determined the use tax did not apply in such limited circumstances. *See* Modern Merchandising, 397 NW2d at 472.

When viewing the billing process as a whole, the facts do not establish a "use" in the state to support taxation. While it cannot be disputed that the South Dakota bills are a product

of Western's business in South Dakota, that is not the test to determine if the billing services are "used" within South Dakota to support the tax. The legislative change to the definition of "use" does not apply in this situation. It is significant that the legislature chose to exclusively incorporate advertising materials to promote or facilitate sales that are sent to the State as part of the definition of "use." Though the result in *Modern Merchandising* has been altered by legislative action, the analytical method remains intact. The legislative modification to the definition of use does not apply and the rationale of *Modern Merchandising* is controlling. Applying these facts to the rationale of *Modern Merchandising,* and even considering the legislative change, the record does not establish the billing services were "used" in the State of South Dakota within the definition of the term as it now exists.

Therefore, I dissent.

AMUNDSON, Retired Justice, joins this dissent.

Appendix B

SIXTH JUDICIAL CIRCUIT COURT
OF SOUTH DAKOTA

Western Wireless Corporation., and Sioux Falls Cellular Communications Corp.	Civ. No. 99-93
Plaintiffs/Appellants	**MEMORANDUM DECISION**
v.	
Department of Revenue	March 29, 2002

Western Wireless Corporation and Sioux Falls Cellular Corporation (hereinafter referred to as Western Wireless) appeal from a Department of Revenue (Department) tax assessment made under SDCL 10-46-2.1. The Department imposed an excise tax hereinafter referred to as a "use tax," on Western Wireless' South Dakota use of out-of-state billing services. Western Wireless obtained the service from Computer Services Corporation (CSC). Western Wireless used the service to bill its South Dakota cellular telephone customers. The use tax is affirmed.

This is the second time this case has been before this Court. The first occasion was a September 15, 1999 oral argument. At that time, the exact nature of the billing service was not clear. During the oral argument, (and based upon the administrative Findings of Fact and Conclusions of Law), this Court was lead to believe that the tax may have only been assessed on one component of the billing service.

That component was the "call rating" process; a process that involved electronic data manipulation to create a bill for each cellular customer using CSC's proprietary software in Illinois. The other components of cellular billing involved review of the electronic data by Western Wireless in Washington, and the printing and mailing the billing

statements by International Billing Services, CSC's third party fulfillment vendor, in California.

Based on the arguments and record made at that oral argument, this Court concluded that the entire billing service was not the subject of the assessment. Because this Court then believed that the tax assessment was only made on a single component of the billing service, the Court concluded that CSC's single component was not subject to use tax.

Following oral argument, and in an attempt to finalize the Findings of Fact and Conclusions of Law, it became apparent that the taxable event at issue may have actually involved all components of the billing service. Consequently, the Department moved this Court to vacate the Court's Bench Decision and affirm the assessment. Because a clear understanding of the taxable event was necessary to resolve this dispute, the matter was remanded to the Office of Hearing Examiners to receive further evidence on the exact nature of the billing service.

On February 13, 2001, this Court was notified that the additional evidence had been considered by the Office of Hearing Examiners; that the supplemented record had been filed with the Hughes County Clerk, and that the matter was ready for decision. See SDCL 1-26-33.6 (it is the duty of counsel to notify the Court when the record has been filed and the case is ready). Subsequent briefing was completed on April 23, 2001.

This Court now concludes that the billing service at issue is subject to use tax because: (1) CSC was responsible for, and Western Wireless acquired from CSC, the complete billing service (data manipulation and the production of the tangible billing statements); and, (2) although each individual component of that billing service was produced in other states, the completed billing service was acquired for "use" in South Dakota to bill Western Wireless' South Dakota customers and to conduct Western Wireless' South Dakota

cellular telephone business. The Court finally concludes that the tax on this use of the billing service in South Dakota did not violate the Commerce or Due Process Clauses of the United States Constitution.

I.
THE NATURE OF THE TAXABLE EVENT

As previously mentioned, a dispute developed during oral argument regarding the exact nature of the billing services provided by CSC. The entire billing process included CSC's "call rating" (data manipulation) in Illinois, Western Wireless' data review in Washington, and the preparation and mailing of the customer statements by a CSC third party fulfillment vendor, International Billing Service, in California.

After considering the additional evidence submitted by the Office of Independent Hearing Examiners, this Court now finds that the service actually taxed was broader than the single component of "call rating" performed by CSC in Illinois. Rather, the tax was assessed on CSC's entire billing service which included all components. Although CSC was not the legal entity that physically performed every component of that billing service, CSC contracted to provide the total billing service which Western Wireless purchased to bill its South Dakota customers.

This finding is supported by administrative Finding of Facts VIII through XI. Those findings reflect that the assessment was made on "the cost per customer . . . for the billing service that [Western Wireless] use[d] in billing the customer." Because Western Wireless refused to produce the financial information concerning its actual cost, the Department's assessment was made on a total cost of $2.50 per customer (based on a CSC contract with a competitor of Western Wireless).

This Court's finding is also supported by the testimony of Western Wireless' representative at the administrative hearing. That testimony reflects that CSC was responsible for the call rating as well as the printing and mailing of customer statements.

> Q. All right. So information is then provided to a billing service out of state, is that true?
>
> A. That's correct.
>
> Transcript page 38, lines 2-4. (emphasis added)
>
> Q. Does the outside vendor in Illinois [CSC] then generate data from which the bills can be run?
>
> A. Yes, the conclusion of that call rating process is data that then ultimately gets printed on paper in the form of the invoice to the customer.
>
> Transcript page 38, lines 22-25 and page 39, line 1. (emphasis added)
>
> Q. And this billing company in Illinois, how do they know where to mail these bills?
>
> A. That's part of the customer profile that's maintained on their system. When a customer subscribes obviously one of the pieces of information that they provide us is a billing address, and it's that billing address that –
>
> Transcript page 53, lines 19-23. (emphasis added)
>
> Q. And the essence of their service, the basic thing is they transform this information on the tape to a bill that the customer receives?
>
> A. Right.
>
> Transcript page 58, lines 1-4. (emphasis added)
>
> Q. Well, this CSC I'm just saying does business in South Dakota – hold it. This CSC is transforming these

recorded calls to bills for people who live in South Dakota?

A. Correct.

Transcript page 58, lines 22-25. (emphasis added)

Q. Does CSC provide Western Wireless with any other services other than this billing service where the cell phone tapes are transcribed to a paper medium?

A. To the best of my knowledge they do not.

Transcript page 63, lines 24-5 and page 64, lines 1-2. (emphasis added)

This testimony reveals that CSC was responsible for the complete billing service.

This finding is finally supported by the contract between Western Wireless and CSC. That contract reveals that the taxable event included all components of the entire billing service. The following contract provisions support this finding.

(A) The contract between Western Wireless and CSC is entitled software license, maintenance and subscriber billing service agreement.

(B) The "background" provisions of the contract reflect: that CSC is in the "subscriber billing business"; that CSC represented that it had experience providing "third party subscriber billing services" to wireless telecommunications companies; that Western Wireless desired to "purchase subscriber billing services," and that CSC desired to provide "subscriber billing services."

(C) Paragraph 1.8 of the contract, in defining a "Data Receipt Date," indicates that date is the date required by CSC for beginning "the production of

[C]ustomer Subscriber Billing Services statement data images."

(D) Paragraph 1.12 of the contract, in defining errors, indicates that an error interferes with CSC's ability to "accurately invoice [Western Wireless'] Subscribers for services provided . . .".

(E) Paragraph 1.31 of the contract provides that CSC contemplated contractual responsibility for CSC's third party fulfillment vendor [the California company that prints and mails the written statement]. This included the responsibility to prepare and deliver the bill to the United States Postal Service. This paragraph specifically refers to "[CSC's] third party fulfillment vendor."

(F) The contract defines "subscriber billing services" as "the calculation and creation of data print images of all Subscriber bills and reports as further detailed in Section 12 of this Agreement and Section 1 of Appendix D."

(G) Paragraph 9.3 of the contract reflects that the testing of the subscriber billing services to be performed under the agreement includes testing of "billing statements."

(H) Paragraph 11.4 of the contract gives CSC a reasonable time to "run a rebilling" to correct errors if CSC is unable to "rebill the Subscriber."

(I) Section 12.2 of the contract, describing "subscriber billing services," indicates that CSC is to "render Subscriber bills" on behalf of Western Wireless. Sections (a) and (b) of this provision specifically deal with CSC's ability to deliver the billing service's "statements to the U.S. Postal Service." Moreover, Section 12.3 provides that Western Wireless agrees to prepay CSC an estimate of the

> postage costs "to be incurred by CSC in fulfillment of CSC's obligation to mail Subscriber Billing Services statements for the billing cycles processed by CSC." This provision also provides that the monthly postage estimate is intended to approximate the monthly postage expense "incurred by CSC on behalf of [Western Wireless] relating to the fulfillment of CSC's obligation to mail [Western Wireless] Subscriber Billing Services statements." (emphasis added)

This Court acknowledges that, under this agreement, CSC contracted with International Billing Service to print and mail the statements. Nevertheless, the billing services contract between CSC and Western Wireless contemplated CSC's contractual responsibility for the complete service. CSC only had discretionary authority to subcontract for printing and mailing services as a part of its obligation to provide the complete subscriber billing service. Although Western Wireless may have even paid CSC for the printing and mailing services separately, the fact remains that CSC was contractually responsible for all services necessary to electronically formulate, print and mail subscriber bills to South Dakota customers.

This Court ultimately finds that the billing service assessed in this case was not just a single component or part of a larger billing service. The assessment was made on the entire billing service which included the electronic data manipulation in Illinois, and the printing and mailing of the subscriber statements in California.

II
WHETHER THE USE OF THE BILLING SERVICE WAS TAXABLE WHEN THE SERVICE WAS PERFORMED OUTSIDE THE STATE.

The South Dakota Supreme Court has considered the circumstances under which out-of-state services are subject

to use tax. The Court adopted a test which simply looks to see whether the out-of-state services are used "to conduct [South Dakota business]." In the Matter of State Use Tax Liability of Thermoset Plastics, Inc. v. State of South Dakota Dept. of Revenue, 473 NW2d 136 (SD 1991).

There can be no dispute that billing customers is a necessary part of conducting a cellular telephone business. Therefore, the billing service was like the out-of-state accounting service considered in Thermoset. Because the billing service was used by Western Wireless to conduct its South Dakota business, the service was subject to the use tax imposed by SDCL 10-46-2.1. Thermoset, 473 NW2d at 139.

Western Wireless' reliance on Modern Merchandising, Inc. v. Dept. of Revenue, 397 NW2d 470 (SD 1986), is inapposite. Modern Merchandising involved the use taxation of tangible personal property under a different statute. Modern Merchandising construed SDCL 10-46-2, which unlike SDCL 10-46-2.1, imposes an excise tax on the privilege of using "tangible personal prperty" in South Dakota. In applying that different statute, the Supreme Court used the different statutory definition of the "use" of personal property. See SDCL 10-46-1 (12). Under that different definition, a taxpayer must have some right or power incident to ownership of tangible personal property before the use of such property is taxable.[5] Id. However, the absence of that element of "right or power" is of no consequence in this case because that requirement is not necessary for the use taxation of services used to conduct South Dakota business under SDCL 10-46-2.1 and Thermoset.

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[5] The contract between Western Wireless and CSC belies Western Wireless' argument even under the Modern Merchandising test. Much of that lengthy contract focused on CSC's ability to accurately produce, and Western Wireless' right to monitor, control and change the billing statement. Therefore, Western Wireless had substantial right, powers and control over the tangible billing statement.

Western Wireless, however, also argues that Thermoset is distinguishable because the taxpayer in that case controlled the cash flow statement and used it for internal purposes. Western Wireless seeks to recharacterize the "service" or taxable event in this case and only look at the "itemized monthly bill sent to customers for their use." Viewed in that isolation, Western Wireless argues that it does not possess or control the printed bill that is mailed to its customers by International Billing Services. However, that is not the taxable event in this case. Here, Western Wireless contracted for a complete billing service rather than just the end result of that billing service. Moreover, Western Wireless actually exercised substantial control over the printed statement.[6]

Western Wireless finally argues that because the billing service was performed outside the state, the tax is exempted by SDCL 10-45-12.3. That statute, however, only provides an exemption "if the use of the service occurs entirely outside the state." Id. Western Wireless is not entitled to the exemption because even though the bills are created in Illinois and California, the service is only used in South Dakota to bill Western Wireless's South Dakota customers.

III
WHETHER THE USE TAX VIOLATES THE COMMERCE CLAUSE AND THE EQUAL PROTECTION CLAUSE OF THE UNITED STATES CONSTITUTION

Western Wireless asserts a new constitutional argument to this Court that was not presented below.[7] Western

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[6] See Supra, note 1.

[7] Western Wireless's Post-Hearing Memorandum reflects that its constitutional argument at the administrative level relied exclusively on SDCL 10-45-12.1. Western Wireless pointed out that § 10-45-12.1 exempts financial services performed by a financial institution if they are subject to South Dakota's financial institution income tax. Western Wireless pointed out that the same services provided by an out-of-state company not subject to the South Dakota financial institution income tax would not be entitled to the exemption. Western

Wireless now argues the Commerce and Due Process Clauses were violated because the tax on billing services had an insufficient nexus with South Dakota, and because the tax was not fairly apportioned. Western Wireless has abandoned the arguments and authorities cited at the administrative level, and it now relies on cases such as Allied-Signal, Inc. v. Director, Div. of Taxation, 504 US 768 (1992); Norton Co. v. Department of Revenue of State of Ill., 340 US 534 (1951); National Geographic Society v. California Bd. of Equalization, 430 US 551 (1977); Standard Pressed Steel Co. v. Washington Dept. of Revenue, 419 US 560 (1975); Goldberg v. Sweet, 488 US 252 (1989); Complete Auto Transit, Inc. v. Brady, 430 US 274 (1977) and Quill Corp. v. North Dakota by and through Heitkanp, 504 US 298 (1992).

The department contends that because Western Wireless' new arguments were not presented at the administrative agency, they may not be raised for the first time on appeal. See Finck v. Northwest School Dist. No. 523, 417 NW 2d 875 (SD 1988); Sharp v. Sharp, 422 NW2d 443, 445 (SD 1988), (holding that a constitutional argument may not be raised for the first time on appeal.)

Wireless argued that CSC, an out-of-state corporation, was providing financial services to Western Wireless and was subject to disparate treatment in violation of the Equal Protection and Commerce Clauses. Western Wireless argued that it would not be subject to this tax if it purchased the same services from a South Dakota bank, but Western Wireless was subject to the tax because it purchased the services from a non-South Dakota service provider. Western Wireless argued that taxing structure gave banks transacting business in South Dakota a competitive advantage over other service providers. It also imposed a heavier tax burden on the customers who purchase those services from the out-of-state businesses. Western Wireless concluded that giving a competitive advantage to financial institutions that transact business in South Dakota discriminated against interstate commerce. Taxpayer's Post-Hearing Memorandum at p. 8. Western Wireless only relied on Supreme Court cases analyzing disparate treatment between corporations doing business within the state and those doing business outside the state. Western Wireless raised no Equal Protection argument at the administrative level.

Western Wireless, however, argues that it is not precluded from raising the new constitutional issues because the administrative Hearing Officer did not have the judicial power to strike down an unconstitutional statute. Western Wireless contends that such power is solely reserved to the judicial branch. See, Wronski v. Sun Oil Co., 310 NW2d 321 (Mich. App. 1981); Nebraska Public Employees, Local No. 251, American Federation of State, County and Municipal Employees, AFL-CIO v. City of Omaha, 457 NW2d 429 (Neb. 1990); First Bank of Buffalo v. Conrad, 350 NW2d 580 (ND 1984). Western Wireless further contends that this Court may address the new constitutional issues because this appeal presents the very first context in which a tribunal hearing the matter has the power and authority to actually rule on the constitutional issues.

As noted in the preceding authorities, administrative agencies generally do not have the power to determine constitutional issues, especially those under which they are to act. Conrad, 350 NW2d at 585. Consequently, notions of exhaustion of administrative remedies are "unwarranted and unnecessary where the constitutionality of the very law in question is raised." Id. citing Bare v. Gorton, 527 P2d 379, 381 (1974).

For this reason, it is generally recognized that the constitutionality of a legislative act may be raised for the first time on appeal from a decision of an administrative agency. In Re Applications A-16027, 495 NW2d 23, 30 (Neb 1993). See also, Froysland v. North Dakota Worker's Compensation Bureau, 432 NW2d 883, 892 (ND 1988), citing Johnson v. Elkin, 263 NW2d 123, 126 (ND 1978) (the question of the constitutionality of an act under which an administrative agency operates may be raised for the first time on appeal to the district court, if based solely on the record made in the administrative agency); Matter of Rochester Ambulance

Service, a Division of Hiawatha Aviation of Rochester, Inc., 500 NW2d 495, 499 (Minn. App. 1993).

This Court concludes that it may consider the constitutional issues raised for the first time on appeal because the issues are being raised at the first opportunity in a forum that possesses subject matter jurisdiction. Padilla v. Minnesota State Bd. of Medical Examiners, at 382 NW2d 876, 882 (Minn. App. 1986).

COMMERCE AND DUE PROCESS CLAUSES[8]

Contemporary Commerce Clause jurisprudence employs a four-part test to sustain a tax against a Commerce Clause challenge. Only two of the four tests are at issue here. The questions are (1) whether South Dakota's use tax applied to an activity with a substantial nexus with South Dakota, and (2) whether the use tax was fairly apportioned.

Western Wireless first contends that South Dakota has an insufficient transactional nexus with the billing service to satisfy this commerce clause requirement. See, Allied-Signal, 504 US at 778. "We have not abandoned the requirement that in the case of a tax on an activity, there must be a connection to the activity itself, rather than a connection only to the actor the State seeks to tax." Id. citing, Quill, 506 US at 306-308. Although the Department disagrees with this

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[8] Although the Due Process Clause and the Commerce Clause are closely related, state taxing schemes that satisfy the Due Process Clause may nevertheless violate the Commerce Clause. Quill, 504 US at 305. The similarities and distinctions are set forth in detail in Quill. Although the United States Supreme Court has favored separate analysis of these claims, they may be easily considered together in this case. Western Wireless' due process claim and its transactional nexus claim under the Commerce Clause, both involve the minimum connection or "transactional nexus" test. Quill, at 306. Like Quill, there is no question in this case that Western Wireless has purposely directed its activities at South Dakota residents. Those contacts are more than sufficient to satisfy the Due Process clause. Therefore, there is no due process infirmity here, and the balance of this opinion is devoted to the Commerce Clause.

proposition, citing National Geographic, 430 US 551, this Court need not address the Department's contention. This Court need not address the Department's contention because the taxable activity at issue here is transactionally related to South Dakota.

It is transactionally related because unlike Norton, the use of cellular billing services in South Dakota to conduct Western Wireless' cellular telephone business is associated with Western Wireless' local business Norton, 340 US at 537. In this case, the transaction taxed - the use of billing services in South Dakota to carry on South Dakota cellular telephone business with South Dakota citizens – has a real and substantial association with Western Wireless' cellular business activities in South Dakota. Like Standard Pressed Steel Co., 419 US at 562, Western Wireless has used the taxed activity (billing services) for the purposed of the "realization and continuance of valuable contractual relations" between Western Wireless and its South Dakota customers. Moreover, Western Wireless has also "so mingled taxable business [its cellular telephone business] with that which it contends is not taxable" (the billing services necessary to operate it's South Dakota business), that the Commerce Clause is not offended. Norton, 340 US at 538. Because the use of billing services in South Dakota is clearly necessary to carry on Western Wireless' local business, the South Dakota tax has a sufficient transactual nexus with South Dakota.

Western Wireless also contends that the use tax is not fairly apportioned. Fair apportionment under the Commerce Clause requires that a tax on interstate commerce be internally and externally consistent. Container Corp. of America v. Franchise Tax Bd., 463 US 159, 169 (1983); Goldberg, 488 US at 261. The purpose of fair apportionment is to insure that each state only taxes its fair share of interstate transactions. Id. at 260-261. This two-pronged

inquiry is designed to detect multiple taxation, "which is threatened when one State's act of overreaching combines with the possibility that another State will claim its fair share of the value taxed...." Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 US 175, 184 (1995).

To be internally consistent, a tax must be structured so that if every state were to impose an identical tax, no multiple taxation would result. Id. at 185. SDCL 10-46-2.1 is internally consistent because it only imposes a use tax on the use of billing services for Western Wireless' South Dakota customers. Because another state with an identical tax would only tax billing services used for Western Wireless' customers in that other taxing state, the other state's tax would not reach billing services used for South Dakota customers. Consequently, no multiple taxation could occur under identical taxes in Illinois, California and South Dakota.

Western Wireless, however, argues: that an identical tax in Washington could reach the "review of invoice calculation" component performed in Washington; that an identical tax in Illinois could reach the "data manipulation service" component performed in Illinois; and, that an identical tax in California could reach the "printing and mailing" component performed in California. This argument is misplaced because as previously indicated, an identical tax in the other states could only extend to the use of billing services for the other states' residents. Therefore, a tax on any billing service component used to bill Washington, Illinois and California residents would not duplicate the South Dakota tax which only reaches the billing services used to bill South Dakota customers. Because the tax at issue can only relate to the use of services for South Dakota customers, SDCL 10-46-2.1 is internally inconsistent. This conclusion is clearly supported by the taxing schemes in Goldberg, 488 US at 261 and Jefferson Lines, 514 US at 185.

Western Wireless finally argues that the use tax is not externally consistent because a similar tax in the other states could also tax the billing services. The external consistency prong of fair apportionment "looks not to the logical consequence of cloning, but to the economic justification for the State's claim upon the value taxed, to discover whether a State's tax reaches beyond that portion of value that is fairly attributable to the economic activity within the taxing State." Jefferson Lines at 185. Under this prong, the threat of multiple taxation (though not by literally identical statutes) may indicate a State's impermissible overreaching. Id.

In this case, the taxable event is the use of the billing service to carry on Western Wireless' business with its South Dakota customers. SDCL 10-46-2.1. Although other states could tax the production components of the billing service, the commerce clause permits "successive taxation of related events up and down the stream of commerce..." Jefferson Lines, 514 US 187. This successive taxation is permitted when the taxable event involves a piece of tangible property (or a service) moving through the stream of commerce. Id. at 188. Thus, when dealing with sales and use taxes, "there is no constitutional trouble inherent in the imposition of a tax in the State of delivery to the customer, even though the State of origin of the thing sold [or service rendered] may have assessed a property or severance tax on it." Id. (internal citations omitted). Because such taxable events involve a consummated sale (or use) of goods, they are properly treated as unique, and taxes on sales and use of goods (or services) proceeding through the stream of commerce are, when found to be internally consistent, also held to be externally consistent as well. Id. Moreover, like Jefferson Lines, the taxable event here involves a combination of events which can only occur in South Dakota. In this case, those events are an agreement between Western Wireless and CSC, Western Wireless' payment for the billing service, and the use of that service in South Dakota for South Dakota

customers. "[N]o other state can claim to be the site of [this] same combination."[5] Id. at 190. Thus, the use of this billing service by this buyer, will not be duplicated as a taxable event in any other state. Id.

Successive taxation, may however, be so closely related that it indicates a potential unfairness when the tax is on the full amount of the sale of services. Id. at 191. Nevertheless, in Jefferson Lines the Supreme Court expressly noted that sales (and therefore use) taxes are subject to special rules on non-apportionment which permit successive taxation "for which the producer may be taxed first...and the customer may later be taxed upon its purchase [in another state]." Id. at 192. Therefore, even if Washington, Illinois or California imposes a tax on the seller of a component of the billing service produced in one of these states, the external consistency test is not violated by a subsequent South Dakota tax on the buyer's use of the entire billing service which is used in South Dakota to bill South Dakota customers. There is external consistency because the entire gross value of the billing service is used to bill and conduct business with South Dakota customers. Therefore, the unapportioned tax, does not reach beyond a value that s fairly attributable to the South Dakota business use.[6]

The assessment is affirmed. Counsel for the Department should submit a conforming judgment.

Dated this 29th day of March, 2002.

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[5] Western Wireless' attempts to dispute this fact by relying on SDCL 10-45 12.3 and Matter of Royal Plastics, Inc.'s Request for Refund of State and Municipal Sales and Use Taxes, 471 NW2d 582 (SD 1991). That case, however, involved a different inquiry involving a taxing scheme on tangible personal property. Here, the relevant inquiry is simply whether the billing service is used to do business in South Dakota. 473 NW2d 136. The Thermoset "use in South Dakota" requirement cannot be claimed by another State.

[6] Because of this conclusion, this Court need not address the issue of credit mechanisms under SDCL 10-46-6.7.

BY THE COURT:

\s\
Steven L. Zinter
Presiding Circuit
Judge

Appendix C

SIXTH JUDICIAL CIRCUIT COURT
OF SOUTH DAKOTA

Western Wireless Corporation., and Sioux Falls Cellular Communications Corp.
Plaintiffs/Appellants

Civ. No. 99-93

JUDGMENT

v.

Department of Revenue

Filed April 11, 2002

The above-captioned matter having come on for hearing, before this Court, the Honorable Steven L. Zinter, Circuit Court Judge, presiding; the Department of Revenue being represented by Jack C. Magee, Attorney at Law; Western Wireless Corporation and Sioux Falls Cellular Communications Corporation being represented by Steven Sanford, Attorney at Law; and the Court having considered the matter upon the oral arguments of the parties, the administrative record, and having considered the briefs of the parties, the Court hereby adopts and enters the following:

IT IS HEREBY ORDERED that the Secretary of Revenue's Final Decision is affirmed, except that the Findings of Fact are hereby modified to include:

"XXIV.

Any additional Findings of Fact included in the Circuit Court's Memorandum Decision dated March 29, 2002 are incorporated by reference herein."; it is

FURTHER ORDERED that the Secretary's Conclusions of law are modified to include:

"VIII.

Any additional Conclusions of Law included in the Circuit Court's Memorandum Decision dated March 29, 2002 are incorporated by reference herein."; it is

FURTHER ORDERED that the assessment issued by the Secretary of Revenue against Western Wireless Corporation and Sioux Falls Cellular Communications Corporation is affirmed in all respects.

Dated this 9th day of April, 2002.

BY THE COURT:

\s\
STEVEN L. ZINTER
CIRCUIT COURT
JUDGE

Appendix D

SOUTH DAKOTA
OFFICE OF THE HEARING EXAMINERS

Western Wireless Corporation., and Sioux Falls Cellular Communications Corp.	**AMENDED PROPOSED DECISION**
v.	
Department of Revenue	**REV 98-13**

An administrative hearing in this matter was held on May 7, 1998. Mr. Steven W. Sanford appeared as counsel for Western Wireless/Sioux Falls Cellular (hereinafter sometimes referred to as Western). Mr. Eric H. Monson appeared as counsel for the Department of Revenue (hereinafter sometimes referred to as Department). Briefs and reply briefs were submitted at later dates.

ISSUES

Based on Western's request for hearing, the following issues were set forth in the Notice of Hearing dated March 17, 1998, and at the time of the hearing:

1. Whether the Certificate of Assessment of the Department of Revenue should be accorded prima facie correct status?
2. Whether the billing services provided by CSC to Western are taxable because the use of such services occurred outside of South Dakota?
3. Whether Western purchases the billing services for resale?
4. Whether the assessment of use tax against Western violates the Commerce Clause and the Equal Protection Clause of the U.S. Constitution?

Both parties submitted briefs and rebuttal briefs.

Based on the evidence presented, the Hearing Examiner enters the following:

FINDINGS OF FACT

I.

Western Wireless Corporation and Sioux Falls Cellular Communications Corporation provide cellular telephone service in South Dakota and in the western half of the United States in mostly rural western areas.

II.

Sioux Falls Cellular was in operation under a South Dakota Department of Revenue Sales Tax license number 51-001-133413748E-ST-001 until late 1995, when Western Wireless took over the company. After that time both the company's revenues were reported on western's sales tax license number 73-001-911638901E-ST-001.

III.

Western's corporate headquarters are located in Issaquah, Washington where Western is a corporation organized under Washington law.

VI.

On April 24, 1997, the department served Notice of Intent to Audit on Western.

V.

Wayne Palmer, Senior Auditor for the Department of Revenue prepared the audit. He has been doing audits since October, 1979. He has a Bachelor of Science degree in accounting and has taken continuing education classes with the Department of Revenue on a yearly basis.

VI.

Palmer began auditing Western beginning October 21, 1997, and concluded January 27, 1998. The audit was held at the offices of Western Wireless in Issaquah, Washington.

VII.

The audit covered business conducted from January 1994 through June 1997.

VIII.

In October 1997, Palmer requested information from Western regarding the number of customers they serviced in South Dakota and what the cost per customer was for the billing service that they use in billing the customer.

IX.

This documentation was requested several times from Western's personnel and finally was requested from Steven Winslow, Western's Director of Taxation.

X.

Winslow testified in the hearing that he refused to provide the Department of Revenue with the needed information.

XI.

Palmer arrived at the amount of $2.50 per customer for billing services from the contract between CSC and a competitor of Western Wireless. Palmer used and applied this information to Western. Without this information the DOR could not finish the audit. TR 11, 12, 14, 18, 19 & 36.

XII.

A Certificate of Assessment was issued on January 27, 1998.

XIII.

The amounts of use tax disputed are $79,022.45 for Sioux Falls Cellular and $153,385.67 for Western for a total of $232,408.12.

XIV.

Western requested an Administrative Hearing on February 25, 2998.

XV.

Western has two mainframe computers in South Dakota that they refer to as switches. One is located in Rapid City, the other in Sioux Falls. These switches record each call made by a subscriber and indicate the length of the call.

XVI.

The tapes from the switches are sent to Computer Sciences Corporation, (hereinafter sometimes referred to as CSC), a billing service provided in Champaign, Illinois, to prepare Western's monthly statements (bills) to customers.

XVII.

CSC goes through the call rating process whereby information is generated from the tapes which indicates the amount the customer is to pay to Western for cellular services.

XVIII.

The information on the statements is reviewed electronically by Western's Revenue Assurance group in Issaquah, Washington.

XIX.

The approved bill is electronically sent to California where it is then printed on paper and deposited in the United State's mail to Western's subscribers in South Dakota.

XX.

Western's subscribers in South Dakota then remit their payments to Western's lock box in Phoenix, Arizona.

XXI.

Department's Exhibit #1 and Exhibit #3 (audit files for Western Wireless and Sioux Falls Cellular) are admitted into evidence. Petitioner's objections are overruled.

XXII.

Any additional Findings of Fact included in the Reasoning section of this decision are incorporated by reference herein.

XXIII.

To the extent any of the foregoing are improperly designated and are instead, Conclusions of Law, they are hereby redesignated and incorporated herein as Conclusions of Law.

REASONING

ISSUE I: Whether the Certificate of Assessment of the Department of Revenue should be accorded prima facie correct status?

Petitioner raised the above issue at the time of the hearing. SDCL 10-59-8 states that:

> If the secretary determines that any taxpayer owes tax, penalty or interest, the secretary shall issue a certificate of assessment and mail a copy of the certificate to the last known address of the taxpayer by certified mail. The certificate of assessment shall be deemed prima facie correct. . . .

The burden is then on the petitioner to prove that the Certificate of Assessment should not be deemed prima facie correct.

The Department issued a Notice of Intent to Audit on April 24, 1997. The audit began on October 21, 1997, and concluded January 27, 1998, with the issuing of the Certificate of Assessment.

It was ascertained during the audit that Western used a billing service, Computer Services Corporation (hereinafter sometimes referred to as CSC) to prepare their bills. CSC is located in Illinois. During the audit Western refused to provide the Department with information regarding the cost of the billing service or whether the service is paid for on a per customer basis or on a lump sum basis. The Department needed this information to compute use tax. Testimony regarding this matter was as follows:

Q. (By Mr. Monson) Mr. Palmer, why did you use this $2.50 figure to determine the cost of these services?

A. When we were at the audit site in October we asked – it was requested from the taxpayer – we were trying to arrive at a way to number for the billing service and it was requested from the taxpayer in October, the number of customers that they had within South Dakota, and also what the cost per customer would be for the billing service that they use in billing the customer for their cellular service or communication services.

Q. So essentially you requested invoices regarding the billing services?

A. Right, any information regarding the number of customers they they have in the state or the amounts paid to their billing service, and if we had the amount paid to the billing service and the customers, we could have worked out a number per customer or something from that information.

Q. And were those documents provided to you?

A. No.

Q. And did you request those documents more than once?

A. Yes.

Q. And who did you make that request to?

A. Jeannie Lance or Michelle Mills at Western Wireless.

Q. Did you ever make that request to Mr. Steven Winslow?

A. Yes, I did.

Q. And what was his response?

A. His response was that we would not receive any information regarding those two areas.

Q. So you had to estimate the cost of the billing services?

A. Yes.

Q. And that was – you were forced to estimate that cost because of the plaintiff's actions?

A. Yes.

Q. That was no choice of the Department?

A. That's correct.

(Hearing Transcript pp. 18 & 19)

Mr. Steve Winslow, Director of Taxation for Western Wireless testified that Western had ""initially declined to provide the information that he [the Department's auditor] had requested of us." (Hearing Transcript p 36) He further stated that his company needed to "understand the legal foundation for this assessment of use tax before we were to provide any of the information he was requesting." (Hearing

Transcript p. 36). When asked if he had received an explanation to his satisfaction, Winslow indicated that the answer given was not to his satisfaction, therefor the information was not turned over to the Department. As of the time of the hearing, Western still had not provided the Department with the requested information.

SDCL 10-45-45 provides that books, records and receipts shall be made available to the Department. It states as follows:

> Every person subject to tax under this chapter shall keep records and books of all receipts and sales, together with invoices, bills of lading, copies of bills of sale, and other pertinent papers and documents. Such books and records and other papers and documents, shall, at all times during business hours of the day, be subject to inspection by the secretary of revenue or his duly authorized agents and employees to determine the amount of tax due. Such books and records shall be preserved for a period of three years unless the secretary of revenue, in writing, authorized their destruction or disposal at an earlier date.

By virtue of doing business in South Dakota, Western was subject to SDCL 10-45. Western did not abide by the above statute. Western had access to this information but it refused to turn it over to the Department. In regard to SDCL 10-45-45, the South Dakota Supreme Court ruled in Karras v. Department of Revenue, 441 NW2d 678 (SD 1989) that "In circumstances where retailers books and records are found to be insubstantial, the Department may resort to other available information and audit techniques to determine whether a sales tax deficiency exists." Karras at 680.

In this matter Western isn't just providing insubstantial information, they are withholding information from their books. Some five months since the conclusion of the audit,

at the time of hearing Western had still not divulged the per customer cost of the billing service CSC provides. Western says the Certificate of Assessment should not be considered to be prima facie correct because billing costs can't be verified. They complain that they can't cross-examine the source of the figure. However, they did have ample opportunity to cross-examine the auditor as to why he chose the dollar amounts he did. That line of questioning was not pursued. What choice did Western leave the Department but to try and ascertain the best estimate possible? Western Wireless can't have it both ways. Western wants to criticize the figures the Department used, yet Western will not disclose the best evidence, which is the actual amount.

The Department did the best they could in estimating a cost for the billing service. They looked to a similarly situated business, which used the same bill processing company. Western made no allegations that the figure used by the Department was wrong.

Based on all of the above, the Certificate of Assessment is prima facie correct. Further, Western did not meet their burden in rebutting the presumption of correctness.

ISSUE II: Whether the billing services provided by CSC to Western are taxable because the use of such services occurred outside of South Dakota?

Western argues that the exemption set forth in SDCL 10-45-12.3 applies. It is the opinion of this examiner that it does not apply. SDCL 10-45-12.3 reads as follows:

> The tax imposed by this chapter upon persons performing services does not apply to transactions if the use of the service occurs entirely outside the state. In instances of services performed on tangible personal property, use of the service occurs in this state if repair, refurbishing, adjustment, calibration, cleaning, maintenance or other services are

performed on tangible personal property in this state.

Western Wireless would argue that nothing is performed for Western's benefit in South Dakota. They would argue that the actual bill is completed in Illinois and that is the only place they obtain a benefit. The information that is needed for Western to ultimately get paid is taken off the switches in either Rapid City or Sioux Falls, South Dakota. The tapes are mailed to Illinois where the data is used to produce a statement. That information is transferred to California where it is printed into a paper monthly statement. The statement is sent to the customer in South Dakota. The customer in South Dakota then pays the bill and mails it to Western's lockbox in Arizona. These are the steps in the process of getting Western paid.

However, the beneficial use of every unit of billing information is in the state where the customer resides. Western has to get information to the customer to ultimately get paid. Unless the information is ultimately transmitted to a SD customer, it is of no good to Western Wireless. In Re Quality Serv. Railcar Repair Corp., 437 N.W.2d 209 (S.D. 1989) sets forth the definition of beneficial use as defined in Black's Law Dictionary. The definition is as follows: The right to use and enjoy property according to one's own liking or so as to derive a profit or benefit from it, including all that makes it desirable or habitable, as light, air, and access; as distinguishable from the mere right of occupancy or possession.... (Emphasis added).

The beneficial use of the billing service is the location where the information is put to use to make a profit. The billing information is used in South Dakota by the Western Wireless customer to pay their bill. The profit reaped by Western comes entirely from this state and is therefore subject to use taxes.

The services of CSC, which are utilized by Western, are subject to use tax.

Issue III: Whether Western purchases the billing service for resale?

South Dakota Administrative Rule 64:06:01:08.03 - - Sale of Service for Resale reads as follows:

> Services which are purchased by a service provider and delivered to the current customer in conjunction with the services contracted to be provided to the customer are considered to be for resale. Receipts from the sale of a service for resale by the customer are not subject to sales tax if the purchaser furnishes a resale certificate, which the seller accepts in good faith.

In order for the transaction to be a sale for resale, the following conditions must be present:

1) The service is purchased for or on behalf of a current customer;

2) The purchaser of the service does not use the service in any manner; and

3) The service is delivered or resold to the customer without any alteration or change.

Western does not meet the conditions precedent for the transaction to be a sale for resale. Condition #1 states that "(T)he service is purchased for or on behalf of a current customer." Western does not purchase CSC billing service for or on behalf of a current customer. Western purchases CSC billing services so the customer can see the amount of money they need to pay Western. Condition #2 states that the purchaser of the service does not use the service in any manner. Western does use CSC's billing service. It uses the service as a vehicle to obtain payment from its customers. Finally, while number three may be applicable to the case at

hand, it is inconsequential because this rule is written in the conjunctive. The transaction must have all three parts to qualify as a sale for resale. The Western/CSC transaction does not and therefor does not constitute a sale for resale.

ISSUE IV: Whether the certificates of assessment of use tax against Western violates the Commerce Clause and the Equal Protection Clause of the U.S. Constitution?

Western Wireless contends that CSC does provide financial services to Western Wireless so it (CSC) it is a financial institution. In making this argument WW is eluding to the argument that since CSC is out of state it is being treated differently than any instate financial institution.

There was no evidence presented by Western that either entity was a financial institution. If fact, on questions presented by the Department of Revenue, Winslow's answers indicated that Western and CSC were not financial institutions at all according to the definition as set forth in 10-43-1(4). since neither CSC not Western are financial institutions the argument regarding the applicability of the Commerce Clause or the Equal Protection Clause of the United State's Constitution is without merit.

CONCLUSIONS OF LAW

I.

The Office of Hearing Examiners has jurisdiction over the parties and subject matter of this hearing. the Office of Hearing Examiners is authorized to conduct the hearing pursuant to the provisions of SDLC 1-26D-4.

II.

This matter is a contested case arising under Title 10 of the South Dakota Codified Laws.

III.

Neither Western Wireless nor CSC are financial institutions based on the legal definition set forth in SDCL 10-43-1(4).

IV.

Western Wireless failed to overcome the presumption of correctness of the Certificate of Assessment.

V.

The provisions of SDCL 10-45 regarding sales tax are applicable to use tax situations via SDCL 10-46-39.

VI.

Any additional Conclusions of Law included in the Reasoning section of this decision are incorporated herein by reference.

VII.

To the extent any of the foregoing are improperly designated and are instead Findings of Fact, they are hereby redisignated and incorporated herein as Findings of Fact.

Based on the above Findings of Fact, Reasoning and Conclusions of Law, the Hearing Examiner enters the following:

ORDER

It is the Order of the hearing Examiner that the Certificate of Assessment issued to Western Wireless Corporation and Sioux Falls Cellular Communications corporation is prima facie correct. Further, the Certificate is valid as to the use tax assigned against Western Wireless Corporation and Sioux Falls Cellular Communications Corporation.

Dated this 2nd day of February, 1999.

\s\
Hillary J. Brady
Hearing Examiner

Appendix E

SOUTH DAKOTA
DEPARTMENT OF REVENUE

Western Wireless Corporation., and Sioux Falls Cellular Communications Corp. **REV 98-13**

FINAL DECISION

v.

Department of Revenue February 3, 1999

After reviewing the record and the Proposed Decision of the Hearing Examiner in this matter,

IT IS HEREBY ORDERED that pursuant to SDCL 1-26D-6, the Hearing Examiners Amended Proposed Decision dated February 2, 1999, is adopted in full.

IT IS FURTHER ORDERED that the appeal of Western Wireless Corporation is denied and the Department of Revenue shall collect tax from Western Wireless Corporation as set forth in this Decision.

IT IS FURTHER ORDERED that Western Wireless Corporation shall pay to the Department of Revenue the sums indicated in the Certificates of Assessment, Western Wireless Corporation in the amount of $158,164.55, and Sioux Falls Cellular Communications Corporation in the amount of $104,588.70, in previously unpaid taxes and interest together with additional interest which may be due until paid.

Parties are hereby advised of the right to further appeal the Final Decision to circuit court within thirty (30) days of receiving such decision pursuant to the authority of SDCL 1-26.

Dated this 3rd day of February, 1999.

\s\
Gary R. Viken,
Secretary of Revenue

Appendix F

SUPREME COURT OF SOUTH DAKOTA

WESTERN WIRELESS CORPORATION, AND SIOUX FALLS CELLULAR COMMUNICATIONS CORPORATION,
Plaintiffs and Appellants,

v.

DEPARTMENT OF REVENUE,
Defendant and Appellee.

No. 22373

Decided July 11, 2003

A petition for rehearing in the above cause having been filed June 23, 2003, and no issue or question of law or fact appearing to have been overlooked or misapprehended, and more than fifteen days (15) having elapsed therefrom and no written statement having been filed with the Clerk of this Court by a majority of the justices requesting a rehearing, now, therefore, in accordance with the Rehearing Procedure Rule of this Court, the petition for rehearing is denied.

DATED at Pierre, South Dakota, this 11th day of July, 2003.

BY THE COURT:

\s\
David Gilbertson,
Chief Justice

Appendix G

CONSTITUTIONAL AND STATUTORY PROVISIONS

United States Constitution, Article I:

Section 8. The Congress shall have Power . . . ; To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes; . . .

South Dakota Codified Laws

10-45-4 -- Tax on receipts from business services. There is hereby imposed a tax at the same rate as that imposed upon sales of tangible personal property in this state upon the gross receipts of any person from the engaging or continuing in the practice of any business in which a service is rendered. Any service as defined by § 10-45-4.1 shall be taxable, unless the service is specifically exempt from the provisions of this chapter.

10-45-6.1 -- Tax on telephone and teletypewriter services—computations—coin telephones. Except as provided in section 1 of this Act, there is hereby imposed on amounts paid for local telephone services, toll telephone services and teletypewriter services, a tax of four percent of the amount so paid. The taxes imposed by this section shall be paid by the person paying for the services. If a bill is rendered the taxpayer for local telephone service or toll telephone service, the amount on which the tax with respect to such services shall be based shall be the sum of all charges for such services included in the bill; except that if a person who renders the bill groups individual items for purposes of rendering the bill and computing the tax, then the amount on which the tax for each such group shall be based shall be the sum of all items within that group, and the tax on the remaining items not included in any such group shall be based on the charge for each item separately. If the tax

imposed by this section with respect to toll telephone service is paid by inserting coins in coin operated telephones, the tax shall be computed to the nearest multiple of five cents, except that, where the tax is midway between multiples of five cents, the next higher multiple shall apply. The tax so paid shall be remitted at the same time as the sales tax imposed by this chapter.

10-45-12.3 – Exemption of services used entirely outside state—instate use defined. The tax imposed by this chapter upon persons performing services does not apply to transactions if the use of the service occurs entirely outside the state. In instances of services performed on tangible personal property, use of the service occurs in this state if repair, refurbishment, adjustment, calibration, cleaning, maintenance or other services are performed on tangible personal property in this state.

10-46-1 – Definition of terms. Terms, as used in this chapter mean:

* * *

(13) "Use," the exercise of right or power over tangible personal property incidental to the ownership of that property, except that it does not include the sale of that property in the regular course of business. "Use" also includes the use of the types of services, the gross receipts from the sale of which are to be included in the measure of the tax imposed by chapter 10-45, and any amendments thereto and the delivery or causing delivery into this state of tangible personal property intended to advertise products or services or promote or facilitate sales to South Dakota residents.

10-46-2 -- Tax on tangible personal property purchased for use in state—rate based on purchase price. An excise tax is hereby imposed on the privilege of the use, storage, and consumption in this state of tangible personal property purchased for use in this state at the same rate of percent of the purchase price of said property as is imposed pursuant to chapter 10-45.

10-46-2.1 -- Tax imposed on use of services—exemption—"Related corporation" defined. For the privilege of using services in South Dakota, except those types of services exempted by § 10-46-17.3 , there is imposed on the person using the service an excise tax equal to four percent of the value of the services at the time they are rendered. However, this tax may not be imposed on any service rendered by a related corporation as defined in subdivision (11) of § 10-43-1 for use by a financial institution as defined in subdivision (4) of § 10-43-1 or on any service rendered by a financial institution as defined in subdivision (4) of § 10-43-1 for use by a related corporation as defined in subdivision (11) of § 10-43-1. For the purposes of this section, the term related corporation includes a corporation which together with the financial institution is part of a controlled group of corporations as defined in 26 U.S.C. § 1563 as in effect on January 1, 1989, except that the eighty percent ownership requirements set forth in 26 U.S.C. § 1563(a)(2)(A) for a brother-sister controlled group are reduced to fifty-one percent. For the purpose of this chapter, services rendered by an employee for the use of his employer are not taxable.

No. 03-539

SUPREME COURT, U.S.
FILED
NOV 0 3 2003
OFFICE OF THE CLERK

In The

Supreme Court of the United States

WESTERN WIRELESS CORPORATION,

Petitioner,

v.

DEPARTMENT OF REVENUE,

Respondent.

On Petition For A Writ Of Certiorari To The Supreme Court Of South Dakota

RESPONDENT'S BRIEF IN OPPOSITION

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COUNTERSTATEMENT OF THE QUESTION PRESENTED

Should the Court grant certiorari to review whether a complementary use tax imposed upon and paid by the purchaser of services performed out-of-state for use within the taxing state is consistent with the Commerce Clause, U.S. Const. art. I, § 8, cl. 3?

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OTHER AUTHORITIES:

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Hellerstein, *Complementary Taxes as a Defense to Unconstitutional State Tax Discrimination*, 39 Tax Lawyer 405, 434, n. 197, 458 (1986) 14

J. Hellerstein & W. Hellerstein, State Taxation ¶ 18.06[2] (3d ed. 2003) 6, 9

BRIEF IN OPPOSITION

Petitioner requests this Court to grant certiorari to review an unremarkable decision of the South Dakota Supreme Court. The decision held that a complementary use tax imposed on and paid by the purchaser of services used within South Dakota but performed out-of-state did not violate the Commerce Clause. The petition should be denied because the question of whether a compensatory use tax may be imposed on an in-state purchaser of services used within the taxing state but performed outside the taxing state is a question that the Court has already addressed and answered in the affirmative and is one that involves no conflict among the lower courts.

STATEMENT OF THE CASE

A. South Dakota's Tax System.

Gross receipts received for providing a service are subject to South Dakota's sales tax, unless otherwise exempt. SDCL 10-45-4. If the sales tax cannot be imposed upon the seller of the service, the purchaser of the service is required to pay a complementary use tax on the value of the service. SDCL 10-46-2.1. Because the use tax imposed by SDCL 10-46-2.1 is complementary to the sales tax, it is not due if sales tax is owed or paid by the seller of a service. SDCL 10-46-6. If another state imposes its sales or use tax on a service before the service is used in South Dakota, a credit is given and the user will not owe use tax to South Dakota. SDCL 10-46-6.1.

B. Factual Background.

The Petitioner, Western Wireless Corporation, is a cellular telephone company with its corporate headquarters located in Issaquah, Washington. Western provides cellular phone services to customers in South Dakota and several other rural western states.

Western's customers receive monthly billing statements for the cellular phone service. Western entered into a contract with Computer Services Corporation ("CSC"), a billing service provider located in Champaign, Illinois. The contract provided that CSC would manage the billing of Western's customers.

Western records its South Dakota customers' cellular phone activity and the length of each customer's call on "switches" located in Sioux Falls, South Dakota and Rapid City, South Dakota. A switch is a mainframe computer that links the wireless network to the local exchange network, directs network traffic, and records cellular call data. Western's employees remove the tapes from the switch and send them to CSC in Champaign, Illinois.

CSC employees take the tapes and the information contained on them and run them through the "call rating process". The call rating process stores each customer's recorded information on a computer. CSC manipulates the data using its own proprietary software so that an electronic bill is generated. CSC electronically sends the bill to Western's Revenue Assurance group in Issaquah, Washington. Western has the power to decide if the electronic bills should be approved or corrected.

After the electronic bills are approved by Western's Revenue Assurance group, the data is sent to CSC's

subcontractor, International Billing Services ("IBS"). IBS takes the data that is in the form of an electronic invoice and prints the bill on paper. A paper bill is mailed via the United States Postal Service to each of Western's customers including those in South Dakota. Western's South Dakota customers then pay their bills. Neither Western nor CSC paid sales tax to any state because neither considered the service to be taxable.

The Department commenced a sales and use tax audit on Western's books and records which resulted in an assessment requiring Western to pay use tax of $232,408.12 on the billing services provided by CSC. The assessment was calculated by taking the value of the service provided by CSC for a customer ($2.50), multiplying that number by the number of Western's customers in South Dakota, and then applying the use tax.

C. Procedural History.

Western filed an administrative appeal and argued that assessment was contrary to state law and in violation of the Commerce Clause. The assessment was affirmed and Western filed an appeal in the state circuit court.

The circuit court affirmed the administrative decision. In holding that the assessment did not violate the Commerce Clause, the circuit court concluded that the tax met the four-part test of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

On further appeal, the South Dakota Supreme Court affirmed the circuit court decision. In its decision, the South Dakota Supreme Court also examined a Commerce Clause issue and a separate state law issue. Although two

Justices dissented from the majority opinion, the dissent focused solely on the majority's holding on the state law issue. In examining the Commerce Clause issue, the court applied the four-part test of *Complete Auto* and concluded that the tax met the requirements for a valid use tax.

First, the court determined that South Dakota has a substantial nexus with the billing services provided by CSC because

> Western provides cellular telephone service to its South Dakota subscribers. It owns communications equipment and conducts business in South Dakota. It employs personnel in South Dakota to install and maintain the equipment. Electronic statistics on subscriber usage are transferred from South Dakota, where it originates, to Western's billing service contractor who, in turn, arranges for the South Dakota customers to receive bills for their usage.

Cert. Pet. App. at 8a. Second, the Court, cited *Haliburton Oil Well Cementing Company v. Reilly*, 373 U.S. 70 (1963), and concluded that the use tax applied equally to in-state and out-of-state transactions because it applies to all services "purchased inside or outside this state when the primary benefit of the service is used or consumed in this state and, at the time of purchase, sales tax was not imposed." Cert. Pet. App. at 9a. Third, the court found that the "use tax is fairly related to state-provided services because Western has the right and benefit of selling its services to South Dakota residents." Cert. Pet. at 9a. Fourth, the court relied on *D.H. Holmes Co., Ltd. v. McNamara*, 486 U.S. 24 (1988), holding that "the use tax does not discriminate against interstate commerce because the tax compensates the state for sales tax imposed on

similar in-state transactions." Cert. Pet. App. at 9a. Finally, the court found that the use tax is fairly apportioned because the tax: (1) reflects the way that Western uses this service because Western receives the service in South Dakota when its South Dakota customers are billed for their cellular usage and the primary benefit of the service is used or consumed in South Dakota; (2) is imposed only on customers receiving service in South Dakota, so that if every other state operated in the same way and taxed the billing service attributable only to its customers, there would be no duplication; and (3) imposes no threat of multiple taxation because South Dakota provides a credit for tax paid in other states. Cert. Pet. App. at 9a-10a (citing *Goldberg v. Sweet*, 488 U.S. 252 (1989)).

REASONS FOR DENYING THE WRIT

Petitioners have failed to identify any grounds warranting a grant of certiorari. The imposition of state use tax on services is not part of an emerging new legislative trend and is not an issue involving lower court conflict. Indeed, Petitioner can cite to no case, either from this Court or any lower court, that conflicts with the South Dakota Supreme Court's decision or that would dictate a different set of rules for a run-of-the mill use tax on services, such as the one at issue in this case. To the contrary, this Court has recognized the validity and applicability of complementary state use taxes to services purchased out of state but used within the taxing state. *See, e.g., Oklahoma Tax Commission v. Jefferson Lines, Inc.*, 514 U.S. 175, 193-194 (1995). The South Dakota

Supreme Court merely applied, correctly, the well-established tests from this Court for determining whether a complementary state use tax is valid under the Commerce Clause. The petition for writ of certiorari should be denied.

ARGUMENTS

I. THIS CASE DOES NOT PRESENT A CONSTITUTIONAL ISSUE OF SIGNIFICANT PUBLIC IMPORTANCE OR AN ISSUE AS TO WHICH THE LOWER COURTS ARE IN CONFLICT.

The petition requests the Court to "grant certiorari in this case to clarify for all states how Commerce Clause limitations on state taxing power apply to the imposition of use tax on services" because there is a growing trend among the states of enacting use taxes on services creating an issue of significant public importance. Cert. Pet. at 7. The Petitioner's allegation of a "growing trend" is simply without merit.

A leading tax scholar recently commented upon the reluctance of states to enact use tax on services purchased from out-of-state providers:

> In fact, this question rarely has arisen, because states have not sought to exercise authority over taxable services purchased from out-of-state service providers to the same extent that they have exercised such authority over tangible personal property purchased from out-of-state sellers.

J. Hellerstein & W. Hellerstein, State Taxation ¶ 18.06[2] (3d ed. 2003).

The Petitioner also misread the Federation of Tax Administrators report. Cert. Pet. at 5. While this report does analyze state sales tax on services, it notes

> The 1996 update reveals that the rate of expansion of the sales tax base to include services has declined. As the improvement of the economy during the past several years has translated into more stable state budgets, state policymakers have been reluctant to impose tax increases or new types of taxes. Indeed, no state has undertaken a broad-based expansion of the sales tax to services since Massachusetts in 1990 and Florida in 1987 (both were subsequently repealed) [footnote omitted]. Also, fewer states enacted legislation expanding the sales tax base to selected services than in earlier years.

FTA Research Report No. 147, Sales Taxation of Services, 1996 Update at 1 (Apr. 1997). Petitioner's suggestion that this South Dakota case presents an issue of rising national importance is unfounded when considered in light of the very treatise Petitioner used as authority.

Even if there were an emerging trend among the states of imposing the type of tax at issue here, the petition would still fail to raise an issue appropriate for this Court's review. The Petitioner fails to cite any lower court decision, state or federal, which conflicts with the South Dakota Supreme Court decision. In fact, the Petitioner does not cite a single case from another jurisdiction that addresses a complementary state use tax. To the extent other states are adopting complementary use taxes on services, those individual state tax systems will be reviewed by the lower courts and the law governing this type of tax will be developed. It is premature and unnecessary for this Court to intervene before the lower courts have

had that opportunity. This Court does not traditionally grant certiorari based on the asserted need to halt purported legislative trends that are untested in the lower courts.

II. THE SOUTH DAKOTA SUPREME COURT'S DECISION CORRECTLY APPLIED THIS COURT'S DECISIONS ADDRESSING THE IMPOSITION OF STATE USE TAXES.

The constitutional issue raised in the petition is not novel or unique. The South Dakota court involved a simple and routine application of the Court's test for complementary use taxes imposed upon transactions in interstate commerce. It is a garden-variety case because it involves no new legal test or theory. In fact, the Petitioner fails to cite any decision from a lower court or this Court that contradicts the decision of the South Dakota Supreme Court.

Quoting from the tax scholar relied upon by the Petitioner regarding the exact issue raised in this case:

> There should be no serious constitutional question, however, about the authority of states to impose a tax on services performed in other states but used or consumed in the taxing state. The legal predicate for imposing a use tax on services is the same as that for imposing a use tax on tangible personal property. The state has ample authority to impose a tax on the use or consumption of both tangible personal property and services in a state. Although the notion of taxing the use of services purchased in other states may seem strange to the casual observer, it is no stranger in theory than the notion of

> taxing the use of tangible personal property purchased in other states.[1]

J. Hellerstein & W. Hellerstein, State Taxation ¶ 18.06[2] (3d ed. 2003).

This Court has acknowledged the validity of complementary use tax imposed on services purchased or performed outside the taxing state but used within the taxing state. *Jefferson Lines*, 514 U.S. at 193-194. The Court stated:

> Since a use tax, or some equivalent on the consumption of services, is generally levied to compensate the taxing State for its incapacity to reach the corresponding sale, it is commonly paired with a sales tax being applicable only when no sales tax has been paid or subject to a credit for any such tax paid. Since any use tax would have to comply with Commerce Clause requirements, the tax scheme could not apply differently to goods and services purchased out of state from those purchased domestically. Presumably, then, it would not apply when another State's sales tax had previously been paid, or would apply subject to credit for such payment. In either event, the Oklahoma ticket purchaser would be free from multiple taxation.

Id. (citations omitted).

The sole question remaining here, therefore, is the rudimentary question of whether the South Dakota

---

[1] Following this discussion, the author provided a synopsis of the circuit court decision in this case.

Supreme Court correctly applied the four-part test of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977) which requires that the tax: (A) is to be applied to a taxpayer with clear nexus in South Dakota and to a transaction with clear nexus to the taxpayer's South Dakota business operations; (B) is fairly apportioned; (C) may not discriminate against interstate commerce; and (D) is to be fairly related to the services provided by the state.

A. Both Western and the billing service have nexus with South Dakota.

The petition vaguely and incorrectly claims that the billing service provided to Western is not sufficiently connected to South Dakota to allow imposition of the use tax.[2] Cert. Pet. at 10, fn. 10, and 13, fn. 11. Nexus is the required connection between the state and the transaction, property, or person the state seeks to tax. *Quill Corporation v. North Dakota*, 504 U.S. 298, 299 (1992). There is a definite and clear connection between South Dakota and the billing service because the billing service is indispensable to Western's South Dakota operations. Western relies on the billing service to generate payment for the cellular phone service it provides. Without the billing service, the most important aspect of its operations, that of getting paid, could not be accomplished. As noted by the lower court, Western has " 'so mingled taxable business [its cellular telephone business] with that which it contends is

[2] The petition makes no claim that the state lacks sufficient nexus with Western.

not taxable' (the billing services necessary to operate its South Dakota business), that the Commerce Clause is not offended." Cert. Pet. App. at 31a (citing *Norton v. Department of Revenue*, 340 U.S. 534, 538 (1951)).

B. The use tax imposed is fairly apportioned.

Western claims that South Dakota's use tax on billing services performed out-of-state creates the impermissible threat of multiple taxation. Cert. Pet. at 10. The South Dakota Supreme Court correctly concluded that the use tax in this case was fairly apportioned.

Whether a tax is fairly apportioned depends on whether it is internally and externally consistent. *Goldberg*, 488 U.S. at 261 (citations omitted); *Jefferson Lines*, 514 U.S. at 185. "Internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear." *Jefferson Lines*, 514 U.S. 185. The use tax is imposed upon the billing services used by Western in conjunction with the cell phone services it provides to South Dakota customers. The use tax is not imposed on billing services used by Western in conjunction with cellular phone services provided to customers located in other states. SDCL 10-45-12.3. If each state imposes use tax on the billing services used in conjunction with the cellular services provided in that same state, the service is taxed only once, and there is no multiple taxation. *Jefferson Lines*, 514 U.S. at 185 (holding that "[i]f every state were to impose a tax identical to Oklahoma's, that is a tax on ticket sales within the state for travel originating there, no sale would be subject to more than one State's tax"). Accordingly, the South

Dakota Supreme Court correctly concluded that South Dakota's imposition of use tax on billing services for cell phone services provided in this state is internally consistent.

External consistency requires that "the State has taxed only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed." *Goldberg*, 488 U.S. at 262. The South Dakota Supreme Court correctly concluded that the use tax assessed here "reasonably reflects the way Western uses this service" and held that the tax reaches only that portion of CSC's billing service that is used by Western in South Dakota and therefore satisfies the external consistency test. Cert. Pet. App. at 9a. The tax satisfies the external consistency test.

C. State use taxes imposed upon services performed outside of the taxing state do not discriminate against interstate commerce.

In order for a complementary state tax to be nondiscriminatory, it must meet the following three conditions: (1) the taxing state must identify the intrastate tax burden the state is attempting to compensate; (2) the tax on interstate commerce must approximate, though not exceed, the amount of tax on the intrastate commerce; and (3) the transactions subject to the interstate and intrastate taxes must be "substantially equivalent." *Fulton Corporation v. Faulkner*, 516 U.S. 325, 332-333 (1996).

Applying *Fulton* to the use tax here, SDCL 10-46-2.1 does not yield a Commerce Clause violation. First, the intrastate tax burden complemented by SDCL 10-46-2.1 is SDCL 10-45-4:

> SDCL 10-45-4. There is hereby imposed a tax at the same rate as that imposed upon sales of tangible personal property in this state upon the gross receipts of any person from the engaging or continuing in the practice of any business in which a service is rendered. Any service as defined by § 10-45-4.1 shall be taxable, unless the service is specifically exempt from the provisions of this chapter.

If CSC were a South Dakota billing service provider, it would be subject to the sales tax imposed by SDCL 10-45-4. SDCL 10-46-2.1 simply provides that in the event the sales tax does not apply to the seller, here CSC, then the buyer of the billing service must pay use tax.

Second, the use tax assessed to Western equals the amount of sales tax that would be due from CSC because if CSC were subject to SDCL 10-45-4, it would owe sales tax only on those billing services associated with Western's South Dakota customers. Billing services associated with Western's non-South Dakota customers would be exempt. SDCL 10-45-12.3. This statute reads as follows:

> SDCL 10-45-12.3. *The tax imposed by this chapter upon persons performing services does not apply to transactions if the use of the service occurs entirely outside the state.* In instances of services performed on tangible personal property, use of the service occurs in this state if repair, refurbishment, adjustment, calibration, cleaning, maintenance, or other services are performed on tangible personal property in this state.

(Emphasis added.) Under this statute, an attempt by South Dakota to impose a sales tax on CSC's billing services directed at Western's out-of-state customers would be invalid. The only part of CSC's service that would be

subject to sales tax would be that part which is directed at Western's South Dakota customers. Accordingly, the only portion of the billing service used by Western subject to the use tax is associated with its South Dakota customers. Application of either the sales tax or the use tax would result in exactly the same amount of tax here. Imposition of use tax against Western satisfies the second condition of the *Fulton* test.

The third prong of this test, the "substantial equivalence" condition, is met for sales and use taxes because "they are strict functional equivalents of one another." *Fulton*, 516 U.S. at 343 (citing Hellerstein, *Complementary Taxes as a Defense to Unconstitutional State Tax Discrimination*, 39 Tax Lawyer 405, 434, n. 197, 458 (1986)). Since SDCL 10-46-2.1 is a complementary use tax to the sales tax imposed by SDCL 10-45-4, the third *Fulton* condition is met.

It is clear that the use tax in question, SDCL 10-46-2.1, as applied to Western's use of billing services satisfies the constitutional requirements for a valid complementary tax. It complements the sales tax on services by ensuring that persons using services in South Dakota pay the same tax, whether the service is purchased from an in-state or out-of-state seller. The Court should conclude that the Commerce Clause is not violated by imposition of use tax on Western's use of the billing services.

D. The complementary use tax is fairly related to the services South Dakota provides to Western.

The petition alleges that South Dakota does not provide the necessary protection and benefits required to

justify imposition of the use tax. Cert. Pet. at 12. Western admits, however, that South Dakota provides necessary "protection and benefit" to justify imposition of sales tax on its cellular phone services. Cert. Pet. at 13. To reconcile these divergent positions, Western argues that "South Dakota . . . does not confer any protections or benefits to the activities of CSC in performing billing services for Western. . . . " *Id.* This argument fails as the focus here is not on CSC, but upon Western. Western is the taxpayer, not CSC.

This argument might have merit if South Dakota were attempting to impose a tax on CSC, the billing service provider. However, as this Court has stated, "[T]he Commerce Clause demands a fair relation between a tax and the benefits conferred upon *the taxpayer* by the state." *Jefferson Lines*, 514 U.S. at 199 (emphasis added). It would be illogical to require there to be a fair relation between the benefits and protections and the service provider, CSC.

South Dakota is not subjecting CSC to the tax and therefore is not required to provide it any benefits or protection. The focus must remain on Western and the admitted undisputed benefits and protection it receives from South Dakota in consideration for the use tax it has been assessed. By Western's own admission, the tax is fairly related to the benefits and protections it receives from South Dakota and there is no constitutional issue to review.

CONCLUSION

The Petition for a Writ of Certiorari should be denied.

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No. 03-539

In The

Supreme Court of the United States

WESTERN WIRELESS CORPORATION,
Petitioner,

v.

DEPARTMENT OF REVENUE,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of South Dakota

PETITIONER'S REPLY BRIEF

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SUMMARY

The issue in this case is whether, consistent with the Commerce Clause, a state may tax a purported in-state "use" of services when (a) they are purchased and performed entirely outside the taxing state, (b) the purchaser of the service performs no act in the taxing state to "use" the services there, and (c) the state has already imposed its sales tax on 100% of the taxpayer's activities within its borders. The significant differences between the nature and use of services – compared with the nature and use of tangible personal property – prevents this Court's prior Commerce Clause jurisprudence from serving as a reliable guide to lower courts in the increasingly important area of use taxes on services. As a result of misreading how the Court's prior cases should apply to such taxes, the South Dakota Supreme Court has issued an opinion that improperly taxes extraterritorial activity and impermissibly subjects interstate commerce to multiple taxation. Certiorari should be granted to clarify the states' permissible reach in taxing the "use" of out-of-state services before more states, like South Dakota, overreach their authority under the Commerce Clause.

ARGUMENT

A. The Commerce Clause prohibits taxes like South Dakota's, which are imposed on events that take place in other states, and which subject interstate commerce to multiple taxation.

1. The Opposition confirms the key events.

Respondent's Brief in Opposition, like its tax, depends upon an implied "use" by Western Wireless of the billing services CSC performs entirely in other states. Br. in Opp. 10-11. As the Opposition confirms, there is no dispute about the actual events and activities of the service provider or the taxpayer (Br. in Opp. 2-3; Pet. 3):

a. What happens in other states?

- Western purchases CSC's billing services at Western's place of business in Washington State.
- CSC's services are performed entirely in Illinois and California.
- Western receives and uses CSC's services (i) in Washington State, where Western manages the billing activities and Western receives, reviews and approves CSC's draft bills, and (ii) in Arizona, where the payments on the bills are received and processed.

b. What does not happen in South Dakota?

- Western does not purchase CSC's billing services in South Dakota.
- CSC does not perform any part of its services in South Dakota.
- Western performs no act in South Dakota that is a "use" of the services – i.e., a taxable event – in South Dakota.
- South Dakota provides no government services or protections to CSC's business activities, which are performed entirely in Illinois and California.
- South Dakota provides no government services or protections to Western's activities making use of CSC's billing services, which activities Western performed entirely in Washington and Arizona.

c. What does happen in South Dakota?

The only events in South Dakota (relevant to the out-of-state billing services) either have already been subjected to the state's sales tax or have been held not subject to its use tax as a matter of state law:

- Some of the paper bills that result from CSC's services in Illinois and California are received via mail by Western's cellular phone subscribers in South Dakota. The South

Dakota courts ruled, as a matter of state law, that Western did not exercise dominion and control over those bills so as to constitute a use in South Dakota. App. 6a, 26a.

- Western provides cellular phone service to subscribers in Western states, including South Dakota. South Dakota imposes its *sales* tax on all of Western's activities in South Dakota – taxing 100% of the revenues Western receives for all its activities and costs in connection with providing phone services to subscribers in that state (including the cost of CSC's billing service). SDCL 10-45-6.1.

2. Extraterritorial taxation – Respondent is silent.

Tellingly, Respondent's Opposition fails to address the extraterritorial imposition of its tax on services that were purchased, performed, received, and used in other states. This extraterritorial taxation is a fatal flaw targeted by the Commerce Clause's requirements of substantial nexus, nondiscrimination, fair apportionment, and fair relationship to services provided by the state. *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768, 777-78 (1992) ("The principle that a State may not tax value earned outside its borders ... focuses on the guidelines necessary to circumscribe the reach of the State's legitimate power to tax"); *see* Pet. 12-13.

3. Respondent also ignores the multiple taxation of interstate commerce.

Those same four requirements aim to prevent another vice the Commerce Clause was intended to eliminate, multiple taxation of interstate commerce. Respondent's Opposition (at 10-15) skims through those requirements on the surface, but ignores the core problems those requirements are meant to solve. South Dakota's imposition of use tax on CSC's out-of-state services violates the Commerce Clause, both because it constitutes actual multiple taxation by South Dakota itself (by imposing both a sales tax and a

"compensatory use tax" on the same in-state activity), and because it subjects Western's use of an interstate billing service to the risk of multiple taxation by multiple states.

If, as South Dakota argues throughout, Western's business of providing ***phone services*** is considered a "use" in South Dakota of the ***billing services*** CSC performs in Illinois and California (Br. in Opp. 10), South Dakota has already fully taxed Western on that purported "use." The Opposition describes a connection between Western's cell phone business (conducted partly in South Dakota) and the billing services – performed by CSC and used by Western outside South Dakota. Western's cost of the billing service is, like all other costs, a component of its charge for cell phone service. South Dakota already imposes sales tax on all of Western's cell phone business in South Dakota, and specifically collects sales tax on Western's charges for cell phone service (of which its billing costs are a component).[1] South Dakota thus single-handedly subjects interstate commerce to multiple taxation.

As discussed in section A.4 *infra*, South Dakota's tax also subjects Western to the risk of multiple taxation, because other states are entitled to tax Western's use of billing services by virtue of the activities conducted in their states.

4. *Jefferson Lines* condemns, rather than supports, South Dakota's use tax in this case.

South Dakota incorrectly claims that the validity of its tax was "acknowledged" by the Court in *Oklahoma Tax Comm'n*

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[1] South Dakota's duplicative use tax on a component cost of Western's already taxed phone service is tantamount to imposing a tax on an automaker's deemed "use" of the engine it purchases when building a car sold to a South Dakota customer. Nor is there any reasoned basis on which to distinguish the billing services involved in this case from any other service a taxpayer outsources in the performance of its overall business – ranging from janitorial services for Western's Washington headquarters to software design services for new switches.

v. Jefferson Lines, Inc., 514 U.S. 175 (1995). Br. in Opp. 9. That case did not involve a use tax on services sold and performed entirely in other states. Rather it considered a sales tax on the in-state sale of a ticket for bus service that originated in-state and was performed partly in-state. As discussed in the Petition (at 10-11), *Jefferson Lines* explained that sales taxes survive Commerce Clause scrutiny because a sale "is most readily viewed as a discrete event ... consummated in *only one state* ... that could not be repeated in other States." 514 U.S. at 186-87 (emphasis added). There is no similar protection from multiple taxation in South Dakota's tax on the purported "use" in South Dakota of services that are performed entirely outside the state.

For tangible property there is one clear situs of use – at its physical location. In stark contrast, the states inconsistently perceive services (because of their intangible nature) to be "used" in many different locations, creating the risk of multiple taxation in each place of potential deemed use.[2] In the treatise on which Respondent relies, Professor Hellerstein expressly notes this contrast:

> [T]he rules regarding the appropriate place of taxation for cross-border sales of services are neither as consistent nor as well established as they are with respect to goods.

J. Hellerstein & W. Hellerstein, *State Taxation* ¶ 18.05[1] (3d ed. 2003). Some states tax services according to where they are performed; some tax according to where the purchaser is located; still others tax according to where the purchaser has

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[2] The constitutional significance of this difference is exacerbated by South Dakota's adoption of such an attenuated notion of the "use" of services. Both the Department and the state courts were explicit that the tax was *not* imposed on any "use" of the paper bills (the tangible manifestation of CSC's services) physically mailed into South Dakota; Western did not exercise sufficient dominion and control over the bills to trigger the state's use tax on tangible property.

access to the services; some tax according to where the services are "delivered" or where they are "enjoyed"; and a few states permit apportionment among the multitude of potentially taxable locations. *Id.*

The billing services at issue here were performed in Illinois and California, and were accessible and provided to Western only at its corporate headquarters in Washington (where it receives, reviews and approves the draft bills, which it cannot access in South Dakota). To the extent Western "uses" CSC's billing services by "getting paid" (Br. in Opp. 5, 10, 11), that "use" occurs in Arizona, where all payments are received and processed. Western is potentially subject to use tax on CSC's entire billing service in each of these states, creating a risk of multiple taxation.[3] As the Court confirmed in *Jefferson Lines*, there is a key constitutional demarcation between taxes on discrete events that occur (and are, therefore, only susceptible to tax) in a single jurisdiction versus taxes on activities subject to the taxing jurisdiction of more than one state. South Dakota's tax on Western's deemed "use" of billing services falls into the latter category because those services were performed, received, and "used" in states other than South Dakota.

Every one of those states has a right, superior to South Dakota's, to tax Western's purchase and use of this billing service. However, *Jefferson Lines* instructs that if only one state is to tax those billing services, it must be the state with a special relationship to the subject of the tax (not merely nexus), such as Illinois (where most of the services were

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[3] The Court has long held that the *risk* of multiple taxation is unconstitutional without the need to prove actual multiple taxation. *Armco, Inc. v. Hardesty*, 467 U.S. 638, 645 n. 8 (1984). Nor is the risk of multiple taxation negated by South Dakota's reciprocal credit mechanism. The Court has expressly condemned reciprocal credit limitations as unconstitutional. *Great Atlantic & Pacific Tea Company v. Cottrell*, 424 U.S. 366, 381 (1976).

performed and from which they were provided to Western) or Washington (where Western purchased, received and managed the services).

5. South Dakota's compensatory tax argument does not save its discriminatory imposition of use tax on out-of-state services.

South Dakota argues that its use tax survives Commerce Clause scrutiny as a compensatory tax. Br. in Opp. 12-14. This argument is wrong for several reasons. The starting point is South Dakota's mistaken claim that its use tax on services is not discriminatory. Br. in Opp. 4. As the Court has expressly held, use taxes are by nature discriminatory because they effectively apply only to out-of-state purchases (in-state transactions are subject instead to sales tax). *Fulton Corporation v. Faulkner*, 516 U.S. 325, 332 (1996). Discriminatory taxes can only be saved when offset by the countervailing impact of a compensatory tax, a claim subject to the "strictest scrutiny." *Oregon Waste Sys. v. Department of Envtl. Quality*, 511 U.S. 93, 99 (1994).

First, because there is no act or event in South Dakota by which Western uses the out-of state services (*supra*, at 2, 3), there is no event in South Dakota that is "substantially equivalent" to CSC's out-of-state performance of billing services. *Maryland v. Louisiana*, 451 U.S. 725 (1981).[4] Second, the activities Western performs in South Dakota are already subject to sales tax – there is no need for a use tax, which is duplicative, not compensatory.

Finally, the state's compensatory tax argument relies on taxes imposed on different taxpayers. Compare Br. in Opp. 13 (CSC would owe sales tax on its services if performed in

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[4] "To be sure, Louisiana has an interest in protecting its natural resources . . . But the First-Use Tax is not designed to meet these same ends since Louisiana has no sovereign interest in being compensated for the severance of resources [outside its borders]." 451 U.S. at 759 .

South Dakota) and 15 ("Western is the [use] taxpayer, not CSC."). *Jefferson Lines* teaches that taxes imposed on different taxpayers "diverge crucially" with respect to application of the Commerce Clause. 514 U.S. at 190.[5]

B. States continue to extend their reliance on use taxation of services, making the issue one of national importance.

Respondent asserts that Western "misread the Federation of Tax Administrators report," claiming that the national importance of the issue in this case is undermined because "*the rate of expansion* of the sales tax base to include services has *declined*" between 1994 and 1996 due to economic growth in the mid 1990s. Br. in Opp. 7 (emphasis added).[6] Notwithstanding cyclical changes in the *pace* of expansion, the FTA concluded that the continued expansion

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[5] In *Jefferson Lines*, the Court carefully distinguished between "standard" sales taxes "payable by the buyer" and other forms of gross receipts taxes "payable by the seller." 514 U.S. 179, n.3. The South Dakota decision also conflicts with an Arizona decision that recognizes the constitutionally significant distinction between a true sales tax imposed on the purchaser and a tax imposed on the seller/service provider. *Southern Pac. Transp. Co. v. Arizona*, 44 P.3d 1006, 1013 (Ariz. Ct. App. 2002) ("Although true 'sales' taxes have a similar appearance and effect, they are substantively distinct").

[6] South Dakota also quotes an excerpt from Professor Hellerstein's hornbook in its attempt to downplay the importance of the issue. Br. in Opp. 6. Ironically, the sentence preceding Respondent's quote expressly identifies the constitutional issue presented by this case:

> When states tax[] services where they are delivered or consumed rather than where they are performed – it can raise the *constitutional question* of whether a state in which the services are delivered or consumed possesses the power to tax services that are performed in other states.

J. Hellerstein & W. Hellerstein, *State Taxation* ¶18.06[2] (3d ed. 2003). The constitutional problem is much more pronounced when, as here, the services are not "delivered or consumed" in South Dakota, but are only perceived to benefit another (already taxed) activity.

is "inexorable." FTA Research Report No. 147, *Sales Taxation of Services*, 1996 Update at 11 (Apr. 1997). Moreover, the economic downturn since that report has created widely reported fiscal crises for all states and increasing pressure to expand their tax bases. As noted in the Petition (and ignored by Respondent), at least three states (Texas, Maine and Virginia) are currently considering substantial expansions of their sales and use tax bases to cover most services. The FTA report also explained that the pressure to expand the sales and use tax base is driven not only by current economic conditions, but also the continuing fundamental shift from a manufacturing to a service based economy. The Court's guidance on the proper application of the Commerce Clause to this increasingly prevalent form of taxation will help states to formulate constitutionally permissible tax systems to meet their fiscal needs, and protect interstate commerce from multiple and extraterritorial taxes that are not borne by local commerce.

CONCLUSION

For the reasons set forth above and in the Petition, Western respectfully requests that the Court grant certiorari to review the state court's decision.

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